KADANT INC
Form 10-K
March 11, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(mark one)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 29, 2007

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-11406

KADANT INC.

(Exact name of registrant as specified in its charter)

Delaware	**52-1762325**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One Technology Park Drive	
Westford, Massachusetts	**01886**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (978) 776-2000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant as of June 30, 2007, was approximately $431,456,000.

As of February 29, 2008, the registrant had 14,272,414 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, to be used in connection with the registrant s 2008 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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Kadant Inc.

Annual Report on Form 10-K

for the Fiscal Year Ended December 29, 2007

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K and the documents that we incorporate by reference in this Report include forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. These forward-looking statements are not statements of historical fact, and may include statements regarding possible or assumed future results of operations. Forward-looking statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management, using information currently available to our management. When we use words such as believes, expects, anticipates, intends, plans, estimates, should, likely, will, would, or similar expressions, we are making forward-looking statements.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions. Our future results of operations may differ materially from those expressed in the forward-looking statements. Many of the important factors that will determine these results and values are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events, or otherwise. For a discussion of important factors that may cause our actual results to differ materially from those suggested by the forward-looking statements, you should read carefully the section captioned Risk Factors in Part I, Item 1A, of this Report.

Item 1. Business

General Development of Business

We were incorporated in Delaware in November 1991 to be the successor-in-interest to several papermaking equipment businesses of Thermo Electron Corporation (Thermo Electron). In November 1992, we completed an initial public offering of a portion of our outstanding common stock. On July 12, 2001, we changed our name to Kadant Inc. from Thermo Fibertek Inc. In August 2001, Thermo Electron disposed of its remaining equity interest in Kadant by means of a stock dividend to its shareholders. Our common stock is listed on the New York Stock Exchange, where it trades under the symbol KAI.

The terms we, us, our, Registrant, or Company in this Report refer to Kadant Inc. and its consolidated subsidiaries.

Description of Our Business

We are a leading supplier of equipment used in the global papermaking and paper recycling industries and also a manufacturer of granules made from papermaking byproducts. Our continuing operations consist of one reportable operating segment, Pulp and Papermaking Systems (Papermaking Systems), and two separate product lines reported in Other Businesses, which include Fiber-based Products and, until its sale in April 2007, Casting Products. In classifying operational entities into a particular segment, we considered how our management assesses performance and makes operating decisions, and aggregated businesses with similar economic characteristics, products and services, production processes, customers, and methods of distribution. In addition, prior to its sale on October 21, 2005, we operated a composite building products business, which is presented as a discontinued operation in the accompanying consolidated financial statements.

Papermaking Systems

Our Papermaking Systems segment has a long and well-established history of developing, manufacturing, and marketing equipment for the global papermaking and paper recycling industries. Some of our businesses or their predecessor companies have been in operation for more than 100 years. Our customer base includes major global paper manufacturers and, with our equipment found in most of the world s pulp and paper mills, we believe we have one of the largest installed bases of equipment in the pulp and paper industry. We manufacture our products in eleven countries in Europe, North and South America, and Asia.

On May 11, 2005, we acquired all the outstanding stock of The Johnson Corporation (Kadant Johnson), a leading supplier of fluid-handling systems and equipment, including steam and condensate systems, components, and controls. These products are used primarily in the dryer section of the papermaking process and during the production of corrugated boxboard, metals, plastics, rubber, textiles, and food. Kadant Johnson was a privately held company based in Three Rivers, Michigan, with approximately 575 employees.

On June 2, 2006, our subsidiary Kadant Light Machinery (Jining) Co., Ltd. (Kadant Jining), assumed responsibility for the operation of Jining Huayi Light Industry Machinery Co., Ltd. (Huayi) and, by September 30, 2006, acquired substantially all of the assets of Huayi, including cash, inventory, machinery, equipment, and buildings for $21.2 million, net of $2.3 million of assumed liabilities (Kadant Jining acquisition). The remaining purchase obligation, which has been accrued as of December 29, 2007, is $1.5 million, of which $0.5 million was paid in January 2008 and the remainder will be paid in 2008 if certain indemnification obligations are satisfied. Huayi was a supplier of stock-preparation equipment in China.

Our Papermaking Systems segment consists of the following product lines: stock-preparation systems and equipment, fluid-handling systems and equipment, paper machine accessory equipment, and water-management systems.

Stock-preparation systems and equipment

We develop, manufacture, and market complete custom-engineered systems and equipment, as well as standard individual components, for pulping, de-inking, screening, cleaning, and refining recycled and virgin fibers to prepare them for entry into the paper machine during the production of recycled paper. Our principal stock-preparation products include:

Recycling and approach flow systems: Our equipment includes pulping, screening, cleaning, and de-inking systems that blend pulp mixtures and remove contaminants, such as ink, glue, metals, and other impurities, to prepare them for entry into the paper machine during the production of recycled paper.

Virgin pulping process equipment: Our equipment includes pulp washing, evaporator, recausticizing, and condensate treatment systems used to remove lignin, concentrate and recycle process chemicals, and remove condensate gases.

Fluid-handling systems and equipment

We develop, manufacture and market rotary joints, precision unions, steam and condensate systems, components, and controls used primarily in the dryer section of the papermaking process and during the production of corrugated boxboard, metals, plastics, rubber, textiles, and food. Our principal fluid-handling systems include:

Rotary joints: Our mechanical devices, used with rotating shafts, allow the transfer of pressurized fluid from a stationary source into and out of rotating machinery for heating, cooling, or the transfer of fluid power.

Syphons: Our devices, installed primarily inside the rotating cylinders of paper machines, are used to force steam once it has cooled into a liquid state (condensate) out of the drying cylinders through rotary joints located on either end.

Turbulator® tube bars: Our steel or stainless steel axial bars, installed on the inside of dryers, are used to induce turbulence in the condensate layer to improve the uniformity and rate of heat transfer (drying rate) of the dryers.

Engineered steam and condensate systems: Our systems control the flow of steam from the boiler to the paper drying cylinders, collect condensed steam, and return it to the boiler to improve energy-efficiency during the paper drying process.

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Paper machine accessory equipment

We develop, manufacture, and market a wide range of doctor systems and related consumables that continuously clean papermaking rolls to keep paper machines running efficiently; doctor blades made of a variety of materials to perform functions including cleaning, creping, web removal, and application of coatings; and profiling systems that control moisture, web curl, and gloss during paper production. Our principal paper machine accessory products include:

Doctor systems and holders: Our doctor systems clean papermaking rolls to maintain the efficient operation of paper machines by placing a blade against the roll at a constant and uniform pressure. A doctor system consists of the structure supporting the blade and the blade holder. A large paper machine may have as many as 100 doctor systems.
Profiling systems: We offer profiling systems that control moisture, web curl, and gloss during paper production.
Doctor blades: We manufacture doctor blades made of a variety of materials including metal, bi-metal, or synthetic materials that perform a variety of functions including cleaning, creping, web removal, or the application of coatings. A typical doctor blade has a life ranging from eight hours to two months, depending on the application.

Water-management systems

We develop, manufacture, and market water-management systems and equipment used to continuously clean paper machine fabrics, drain water from pulp mixtures, form the sheet or web, and filter the process water for reuse. Our principal water-management systems include:

Shower and fabric-conditioning systems: Our shower and fabric-conditioning systems assist in the removal of contaminants that collect on paper machine fabrics used to convey the paper web through the forming, pressing, and drying sections of the paper machine. The average paper machine has between 3 and 12 fabrics. These fabrics can easily become contaminated with fiber, fillers, pitch, and dirt that can have a detrimental effect on paper machine performance and paper quality. Our shower and fabric-conditioning systems assist in the removal of these contaminants.
Formation systems: We supply structures that drain, purify, and recycle process water from the pulp mixture during paper sheet and web formation.
Water-filtration systems: We offer a variety of filtration systems and strainers that remove contaminants from process water before reuse and recover reusable fiber for recycling back into the pulp mixture.

Other Businesses

Our other businesses include our Fiber-based Products business and, prior to its sale on April 30, 2007, our Casting Products business.

Our Fiber-based Products business produces biodegradable, absorbent granules from papermaking byproducts for use primarily as carriers for agricultural, home lawn and garden, and professional lawn, turf and ornamental applications, as well as for oil and grease absorption.

Our Casting Products business manufactured grey and ductile iron castings. We sold this business on April 30, 2007.

Discontinued Operation

On October 21, 2005, our Kadant Composites LLC subsidiary (Composites LLC) sold substantially all of its assets to LDI Composites Co. for approximately $11.9 million in cash and the assumption of $0.7 million of liabilities, resulting in a cumulative loss on sale of $0.1 million. Under the terms of the asset purchase agreement, Composites LLC retained certain liabilities associated with the operation of the business prior to the sale, including warranty obligations related to products manufactured prior to the sale date. All activity related to this business is classified in the results of the discontinued operation in the accompanying consolidated financial statements.

Through the sale date of October 21, 2005, Composites LLC offered a standard limited warranty to the owner of its decking and roofing products, limited to repair or replacement of the defective product or a refund of the original purchase price. Through the second quarter of 2006, Composites LLC recorded an estimate for warranty-related costs at the time of sale based on its actual historical return rates and repair costs, as well as other analytical tools for estimating future warranty claims. These estimates were revised for variances between actual and expected claims rates. Composites LLC s analysis of expected warranty claims rates included detailed assumptions associated with potential product returns, including the type of product sold, temperatures at the location of installation, density of boards, and other factors. Certain assumptions, such as the effect of weather conditions and high temperatures on the product installed, included inherent uncertainties that contributed to variances between actual and expected claims rates.

During the third quarter of 2006, Composites LLC concluded that the assumptions noted above were not accurately predicting the actual level of warranty claims, making it no longer possible to calculate a reasonable estimate of the future level of potential warranty claims. Accordingly, as no amount within the total range of loss represents a best estimate of the ultimate loss to be recorded, Composites LLC is required under SFAS No. 5, Accounting for Contingencies (SFAS 5), to record the minimum amount of the potential range of loss for products under warranty. As of December 29, 2007, the accrued warranty costs associated with the composites business were $2.1 million, which represent the low end of the estimated range of warranty reserve required based on the level of claims received through the end of 2007. Composites LLC has calculated that the total potential warranty cost ranges from $2.1 million to approximately $13.1 million (See *Warranty Obligations for Discontinued Operation* in Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations of this Report for further information.). The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty. Composites LLC retained all of the cash proceeds received from the asset sale and continued to administer and pay warranty claims from the sale proceeds into the third quarter of 2007. On September 30, 2007, Composites LLC announced that it no longer had sufficient funds to honor warranty claims, was unable to pay or process warranty claims, and ceased doing business. Composites LLC will continue to record adjustments to accrued warranty costs to reflect the minimum amount of the potential range of loss for products under warranty based on judgments entered against it in litigation.

Composites LLC s inability to pay or process warranty claims has exposed the Company to greater risks associated with litigation. For more information regarding our current litigation arising from these claims, please see Part I, Item 3 Legal Proceedings as well as the other risk factors related to litigation set forth in this section.

Research and Development

We develop a broad range of products for all facets of the markets we serve. We focus our research and development efforts on the technological advancement of our stock-preparation, paper machine accessory, fluid-handling, and water-management products.

Our research and development expenses from continuing operations were $6.0 million, $6.2 million, and $4.9 million in 2007*, 2006, and 2005, respectively.

* Unless otherwise noted, references to 2007, 2006, and 2005 in this Annual Report on Form 10-K are for the fiscal years ended December 29, 2007, December 30, 2006, and December 31, 2005, respectively.

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Raw Materials

Raw materials, components, and supplies for our significant products are available either from a number of different suppliers or from alternative sources that we believe could be developed without a material adverse effect on our business.

The raw material used in the manufacture of our fiber-based granules is obtained from three paper recycling mills. The mills have the exclusive right to supply papermaking byproducts to our existing granulation plant in Green Bay, Wisconsin, under contracts which expire in December 2009 and are renewable every two years by mutual agreement. Although we believe that our relationships with the mills are good, the mills may not agree to renew the contracts upon their expiration. In the past, we have experienced some difficulty in obtaining sufficient raw material to operate at optimal production levels. We continue to work with the mills to ensure a stable supply of raw material. To date, we have been able to meet all of our customer delivery requirements, but there can be no assurance that we will be able to meet future delivery requirements. If the mills were unable or unwilling to supply us sufficient fiber, we would be forced to find an alternative supplier for this raw material.

Patents, Licenses, and Trademarks

We protect our intellectual property rights by applying for and obtaining patents when appropriate. We also rely on technical know-how, trade secrets, and trademarks to maintain our competitive position. We also enter into license agreements with others to grant and/or receive rights to patents and know-how.

Papermaking Systems

We have numerous U.S. and foreign patents, including foreign counterparts to our U.S. patents, expiring on various dates ranging from 2008 to 2026. No particular patent, or related group of patents, is so important that its loss would significantly affect our operations. From time to time, we enter into licenses of products with other companies serving the pulp, papermaking, converting, and paper recycling industries.

Other Businesses

We currently hold several U.S. patents, expiring on various dates ranging from 2008 to 2021, related to various aspects of the processing of fiber-based granules and the use of these materials in the agricultural, professional turf, home lawn and garden, general absorption, oil and grease absorption, and catbox filler markets. We also have foreign counterparts to certain of these U.S. patents in Canada.

Seasonal Influences

Papermaking Systems

There are no material seasonal influences on this segment s sales of products and services.

Other Businesses

Our fiber-based granular products business experiences fluctuations in sales, usually in the third and fourth quarters, when sales decline due to the seasonality of the agricultural and home lawn and garden markets.

Working Capital Requirements

There are no special inventory requirements or credit terms extended to customers that would have a material adverse effect on our working capital.

Dependency on a Single Customer

No single customer accounted for more than 10% of our consolidated revenues or more than 10% of the Papermaking Systems segment s revenues in any of the past three years. Revenues from China were $76.6 million, $71.3 million, and $29.2 million in 2007, 2006, and 2005, respectively, representing 21% of total revenues for each of 2007 and 2006 and 12% for 2005.

Backlog

Our backlog of firm orders for the Papermaking Systems segment was $108.6 million and $70.4 million at year-end 2007 and 2006, respectively. We anticipate that substantially all of the backlog at December 29, 2007 will be shipped or completed during the next 12 months. Some of these orders can be canceled by the customer upon payment of a cancellation fee.

Competition

We face significant competition in each of our principal markets. We compete primarily on the basis of quality, price, service, technical expertise, and product performance and innovation. We believe the reputation that we have established for quality products and in-depth process knowledge provides us with a competitive advantage. In addition, a significant portion of our business is generated from our existing worldwide customer base. To maintain this base, we have emphasized technology, service, and a problem-solving relationship with our customers.

We are a leading supplier of stock-preparation equipment used for the preparation of recycled and virgin fibers in the production of recycled paper. Several major competitors supply various pieces of equipment for this process. Our principal competitors in this market are Voith Paper GmbH, Groupe Laperriere & Verrault Inc., Metso Corporation, and Maschinenfabrik Andritz AG. We compete in this market primarily on the basis of technical expertise, product innovation, and price. Other competitors specialize in segments within the white- and brown-paper markets.

We are a leading supplier of specialty accessory equipment for paper machines. Our principal global competitors in this market are Joh. Clouth GmbH & Co. KG and Metso Corporation. Because of the high capital cost of paper machines and the role of our accessories in maintaining the efficiency of these machines, we generally compete in this market on the basis of service, technical expertise, performance, and price.

We are a leading supplier of fluid-handling systems and equipment, offering global sales and service, application expertise, and an extensive rotary joint product line. There are numerous competitors in this market, including Deublin Company, Barco Company, Christian Maier GmbH & Co. KG, and Duff-Norton Company. In addition, due to the highly fragmented nature of the rotary joint market, we compete with numerous local competitors. We generally compete in this market based on process knowledge, technical competency, product and service quality, and price.

In our water-management product line, various competitors exist in the formation, shower and fabric-conditioning systems, and filtration systems markets. Principal competitors are IBS-Paper Performance Group in formation and shower and fabric conditioning systems and Asten/Johnson Foils in formation tables. In addition, a variety of smaller companies compete within the shower and fabric-conditioning systems and filtration systems markets. In each of these markets, we generally compete on the basis of process knowledge, application experience, product quality, service, and price.

Environmental Protection Regulations

We believe that our compliance with federal, state, and local environmental protection regulations will not have a material adverse effect on our capital expenditures, earnings, or competitive position.

Employees

As of December 29, 2007, we had approximately 2,000 employees worldwide.

Financial Information

Financial information concerning our segment and product lines is summarized in Part IV, Item 15, Exhibits and Financial Statement Schedules, Note 11 to the audited consolidated financial statements, which begins on page F-1 of this Report.

Financial information about exports by domestic operations and about foreign operations is summarized in Part IV, Item 15, Exhibits and Financial Statement Schedules, Note 11 to the audited consolidated financial statements, which begins on page F-1 of this Report.

Available Information

We file annual, quarterly, and current reports, proxy statements, and other documents with the Securities and Exchange Commission (SEC) under the Exchange Act. The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers, including us, that file electronically with the SEC. The public can obtain any documents that we file with the SEC at www.sec.gov. We also make available free of charge through our website at www.kadant.com our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these Reports filed with or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file these materials with, or furnish them to, the SEC. We are not including the information contained in our website as part of this Report nor are we incorporating the information on our website into this Report by reference.

Executive Officers of the Registrant

The following table summarizes certain information concerning individuals who are our executive officers as of March 1, 2008:

Name	**Age**	**Present Title (Fiscal Year First Became Executive Officer)**
William A. Rainville	66	Chairman of the Board, President, and Chief Executive Officer (1991)
Edward J. Sindoni	63	Executive Vice President and Chief Operating Officer (1994)
Thomas M. O Brien	56	Executive Vice President and Chief Financial Officer (1994)
Jonathan W. Painter	49	Executive Vice President (1997)
Eric T. Langevin	45	Senior Vice President (2006)
Sandra L. Lambert	52	Vice President, General Counsel, and Secretary (2001)
Michael J. McKenney	46	Vice President, Finance and Chief Accounting Officer (2002)

Mr. Rainville has been president and chief executive officer since our incorporation in 1991, a member of our board of directors since 1992, and chairman of our board since 2001. Prior to our spin-off in 2001, Mr. Rainville also held various managerial positions with Thermo Electron, including chief operating officer, recycling and resource recovery, a position he held since 1998, and for more than five years prior to that, senior vice president. Prior to joining Thermo Electron, Mr. Rainville held positions at Drott Manufacturing, Paper Industry Engineering, and Sterling Pulp and Paper.

Mr. Sindoni was named an executive vice president and our chief operating officer in March 2006 and is responsible for global operations. Prior to that, he served as a senior vice president from 2001 to 2006 with responsibility for our paper machine accessory equipment and water-management systems product lines. From

1992 to 2001, he served as a vice president. Prior to joining us in 1987, he had a 21-year career with the General Electric Company.

Mr. O Brien has been an executive vice president since 1998 and our chief financial officer since 2001. He served as our treasurer from 2001 to February 2005 and also as vice president, finance, from 1991 to 1998. Prior to joining us, Mr. O Brien held various finance positions at Racal Interlan, Inc., Prime Computer, Compugraphic Corporation, and the General Electric Company.

Mr. Painter has been an executive vice president since 1997 and is responsible for our fiberline business, consisting of our stock-preparation product line, and our fiber-based products business. Prior to that, he served as president of our composite building products business from 2001 until its sale in 2005. He also served as our treasurer and treasurer of Thermo Electron from 1994 until 1997. Prior to 1994, Mr. Painter held various managerial positions with us and at Thermo Electron.

Mr. Langevin has been a senior vice president since March 1, 2007 and is responsible for our paperline business consisting of our paper machine accessory equipment, fluid-handling, and water-management systems product lines. Prior to that, he served as vice president, with responsibility for our paper machine accessory equipment and water-management systems product lines from 2006 to 2007. From 2001 to 2006, Mr. Langevin was president of our Kadant Web Systems Inc. subsidiary and before that served as its senior vice president and vice president of operations. Prior to 2001, Mr. Langevin managed several product groups and departments within Kadant Web Systems after joining us in 1986 as a product development engineer.

Ms. Lambert has been a vice president and our general counsel since 2001, and our secretary since our incorporation in 1991. Prior to joining us, she was a vice president and secretary of Thermo Electron since 1999 and 1990, respectively, and before that was a member of Thermo Electron s legal department.

Mr. McKenney has been our vice president, finance and chief accounting officer since January 2002, and served as our corporate controller since 1997. Mr. McKenney was controller of Kadant AES, our division acquired from Albany International Inc., from 1993 to 1997. Prior to 1993, Mr. McKenney held various financial positions at Albany International.

Item 1A. Risk Factors

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we wish to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect, our actual results and could cause our actual results in 2008 and beyond to differ materially from those expressed in any forward-looking statements made by us, or on our behalf.

Our business is dependent on the condition of the pulp and paper industry.

We sell products primarily to the pulp and paper industry, which is a cyclical industry. Generally, the financial condition of the global pulp and paper industry corresponds to the condition of the general economy, as well as to a number of other factors, including pulp and paper production capacity relative to demand. In recent years, the paper industry in certain geographic regions, notably Europe and North America, has undergone a number of structural changes, including decreased spending, mill closures, consolidations, and bankruptcies, all of which have adversely affected our business. In addition, paper producers have been and continue to be negatively affected by higher operating costs, especially higher energy and chemical costs. We believe paper companies remain cautious about increasing their capital and operating spending in the current market environment. As paper companies consolidate in response to market weakness, they frequently reduce capacity and postpone or even cancel capacity addition or expansion projects. These actions can adversely affect our revenue and profitability globally or in a particular region or product line.

A significant portion of our international sales has, and may in the future, come from China and we operate several manufacturing facilities in China, which expose us to political, economic, operational and other risks.

We have significant revenues from China, operate significant facilities in China, and expect to manufacture and source more of our equipment and components from China in the future. During 2007 and 2006, approximately $76.6 million and $71.3 million, respectively, or 21% of our total revenues in each year were from customers in China. Our manufacturing facilities in China, as well as the significant level of revenues from China, expose us to increased risk in the event of changes in the policies of the Chinese government, political unrest, unstable economic conditions, or other developments in China or in U.S.-China relations that are adverse to trade, including enactment of protectionist legislation or trade or currency restrictions. In addition, orders from customers in China, particularly for large stock-preparation systems that have been tailored to a customer s specific requirements, have credit risks higher than we generally incur elsewhere, and some orders are subject to the receipt of financing approvals from the Chinese government. For this reason, we do not record signed contracts from customers in China for large stock-preparation systems as orders until we receive the down payments for such contracts. The timing of the receipt of these orders and the down payments are uncertain and there is no assurance that we will be able to recognize revenue on these contracts. We may experience a loss if the contract is cancelled prior to the receipt of a down payment in the event we commence engineering or other work associated with the contract. In addition, we may experience a loss if the contract is cancelled prior to the receipt of a letter of credit covering the remaining balance of the contract. Typically, the letter of credit represents 80% or more of the total order.

Our business is subject to economic, currency, political, and other risks associated with international sales and operations.

During 2007 and 2006, approximately 61% of our sales were to customers outside the United States, principally in China and Europe. In addition, we operate several manufacturing operations worldwide, including China, Mexico, and Brazil. International revenues and operations are subject to a number of risks, including the following:

- agreements may be difficult to enforce and receivables difficult to collect through a foreign country s legal system,
- foreign customers may have longer payment cycles,
- foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs, adopt other restrictions on foreign trade, impose currency restrictions or enact other protectionist or anti-trade measures,
- it may be difficult to repatriate funds, due to unfavorable tax consequences or other restrictions or limitations imposed by foreign governments, and
- the protection of intellectual property in foreign countries may be more difficult to enforce.

Although we seek to charge our customers in the same currency in which our operating costs are incurred, fluctuations in currency exchange rates may affect product demand and adversely affect the profitability in U.S. dollars of products we provide in international markets where payment for our products and services is made in their local currencies. In addition, our inability to repatriate funds could adversely affect our ability to service our debt obligations. Any of these factors could have a material adverse impact on our business and results of operations.

We are subject to intense competition in all our markets.

We believe that the principal competitive factors affecting the markets for our products include quality, price, service, technical expertise, and product innovation. Our competitors include a number of large multinational corporations that may have substantially greater financial, marketing, and other resources than we do. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in

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customer requirements, or to devote greater resources to the promotion and sale of their services and products. Competitors technologies may prove to be superior to ours. Our current products, those under development, and our ability to develop new technologies may not be sufficient to enable us to compete effectively. Competition, especially in China, has increased as new companies enter the market and existing competitors expand their product lines and manufacturing operations.

Our debt may adversely affect our cash flow and may restrict our investment opportunities.

In 2008, we entered into a five-year unsecured revolving credit facility (2008 Credit Agreement) in the aggregate principal amount of up to $75 million, which includes an uncommitted unsecured incremental borrowing facility of up to an additional $75 million. We borrowed $20 million under the 2008 Credit Agreement and we have also borrowed additional amounts under other agreements to fund acquisitions and grow our business. We may also obtain additional long-term debt and working capital lines of credit to meet future financing needs, which would have the effect of increasing our total leverage.

Our indebtedness could have negative consequences, including:

- increasing our vulnerability to adverse economic and industry conditions,
- limiting our ability to obtain additional financing,
- limiting our ability to pay dividends on or to repurchase our capital stock,
- limiting our ability to acquire new products and technologies through acquisitions or licensing agreements, and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industries in which we compete.

Our existing indebtedness bears interest at floating rates and as a result, our interest payment obligations on our indebtedness will increase if interest rates increase. To reduce the exposure to floating rates, $24.3 million, or 70%, of our outstanding floating rate debt as of February 13, 2008 was hedged through interest rate swap agreements.

Our ability to satisfy our obligations and to reduce our total debt depends on our future operating performance and on economic, financial, competitive, and other factors beyond our control. Our business may not generate sufficient cash flows to meet these obligations or to successfully execute our business strategy. If we are unable to service our debt and fund our business, we may be forced to reduce or delay capital expenditures or research and development expenditures, seek additional financing or equity capital, restructure or refinance our debt, or sell assets. We may not be able to obtain additional financing or refinance existing debt or sell assets on terms acceptable to us or at all.

Restrictions in our 2008 Credit Agreement may limit our activities.

Our 2008 Credit Agreement contains, and future debt instruments to which we may become subject may contain, restrictive covenants that limit our ability to engage in activities that could otherwise benefit us, including restrictions on our ability and the ability of our subsidiaries to:

- incur additional indebtedness,
- pay dividends on, redeem, or repurchase our capital stock,
- make investments,
- create liens,
- sell assets,
- enter into transactions with affiliates, and
- consolidate, merge, or transfer all or substantially all of our assets and the assets of our subsidiaries.

We are also required to meet specified financial ratios under the terms of our 2008 Credit Agreement. Our ability to comply with these financial restrictions and covenants is dependent on our future performance, which is

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subject to prevailing economic conditions and other factors, including factors that are beyond our control such as foreign exchange rates, interest rates, changes in technology, and changes in the level of competition.

Our failure to comply with any of these restrictions or covenants may result in an event of default under our 2008 Credit Agreement and other loan obligations, which could permit acceleration of the debt under those instruments and require us to repay the debt before its scheduled due date.

If an event of default occurs, we may not have sufficient funds available to make the required payments under our indebtedness. If we are unable to repay amounts owed under our debt agreements, those lenders may be entitled to foreclose on and sell the collateral that secures our borrowings under the agreements.

The inability of Kadant Composites LLC to pay claims against it has exposed us to litigation, which if we are unable to successfully defend, could have a material adverse effect on our consolidated financial results.

On October 21, 2005, our Kadant Composites LLC subsidiary (Composites LLC) sold substantially all of its assets to LDI Composites Co. (Buyer) for approximately $11.9 million in cash and the assumption of $0.7 million of liabilities, resulting in a cumulative loss on sale of $0.1 million. Under the terms of the asset purchase agreement, Composites LLC retained certain liabilities associated with the operation of the business prior to the sale, including warranty obligations related to products manufactured prior to the sale date (Retained Liabilities), and, jointly and severally with its parent company Kadant Inc., agreed to indemnify the Buyer against losses caused to the Buyer arising from claims associated with the Retained Liabilities. The indemnification obligation is contractually limited to approximately $8.9 million. All activity related to this business is classified in the results of the discontinued operation in our consolidated financial statements.

Composites LLC retained all of the cash proceeds received from the asset sale and continued to administer and pay warranty claims from the sale proceeds into the third quarter of 2007. On September 30, 2007, Composites LLC announced that it no longer had sufficient funds to honor warranty claims, was unable to pay or process warranty claims, and ceased doing business. We are now co-defendants in a purported consumer class action, together with Composites LLC and another defendant, arising from these warranty claims. In subsequent disclosures in this litigation, plaintiffs claim that such damages exceed $50 million. A judgment or a settlement of the claims against the defendants could have a material adverse impact on our consolidated financial results. For more information regarding our current litigation, see Part I, Item 3, Legal Proceedings. There also can be no assurance that creditors or other claimants against Composites LLC will not seek other parties, including the Company, against whom to assert claims. While we believe any such asserted or possible claims against us or the Buyer would be without merit the cost of litigation and the outcome, if we were unable to successfully defend such claims, could adversely affect our consolidated financial results.

An increase in the accrual for warranty costs of the discontinued operation adversely affects our consolidated financial results.

The discontinued operation has experienced significant liabilities associated with warranty claims related to its composite decking products manufactured prior to the sale date. The accrued warranty costs of the discontinued operation are estimated based on the level of claims processed (see *Discontinued Operation* in the Overview section for a detailed description of the methodology used). The accrued warranty costs of the discontinued operation as of December 29, 2007 represents the low end of the estimated range of warranty costs required based on the level of claims received through the end of 2007. Composites LLC has calculated that the total potential warranty cost ranges from $2.1 million to approximately $13.1 million. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty. On September 30, 2007, the discontinued operation ceased doing business and has no employees or other service providers to collect or process warranty claims. Composites LLC will continue to record adjustments to accrued warranty costs to reflect the minimum amount of the potential range of loss for products under warranty based on judgments entered against it in litigation, which will adversely affect our consolidated results.

Our inability to successfully identify and complete acquisitions or successfully integrate any new or previous acquisitions could have a material adverse effect on our business.

Our strategy includes the acquisition of technologies and businesses that complement or augment our existing products and services. Our most recent acquisition was the Kadant Jining acquisition in June 2006. Any such acquisition involves numerous risks that may adversely affect our future financial performance and cash flows. These risks include:

- competition with other prospective buyers resulting in our inability to complete an acquisition or in us paying substantial premiums over the fair value of the net assets of the acquired business,
- inability to obtain regulatory approval, including antitrust approvals,
- difficulty in assimilating operations, technologies, products and the key employees of the acquired business,
- inability to maintain existing customers or to sell the products and services of the acquired business to our existing customers,
- diversion of management s attention away from other business concerns,
- inability to improve the revenues and profitability or realize the cost savings and synergies expected in the acquisition,
- assumption of significant liabilities, some of which may be unknown at the time,
- potential future impairment of the value of goodwill and intangible assets acquired, and
- identification of internal control deficiencies of the acquired business.

We may be required to reorganize our operations in response to changing conditions in the paper industry, and such actions may require significant expenditures and may not be successful.

In the past, we have undertaken various restructuring measures in response to changing market conditions in the paper industry. We may engage in additional cost reduction programs in the future. We may not recoup the costs of programs we have already initiated, or other programs in which we may decide to engage in the future, the costs of which may be significant. In connection with any future plant closures, delays or failures in the transition of production from existing facilities to our other facilities in other geographic regions could also adversely affect our financial operations. In addition, our profitability may decline if our restructuring efforts do not sufficiently reduce our future costs and position us to maintain or increase our sales.

Our fiber-based products business is subject to a number of factors that may adversely influence its profitability, including high costs of natural gas and dependence on a few suppliers of raw materials.

We use natural gas in the production of our fiber-based granular products, the price of which is subject to fluctuation. We seek to manage our exposure to natural gas price fluctuations by entering into short-term forward contracts to purchase specified quantities of natural gas from a supplier. We may not be able to effectively manage our exposure to natural gas price fluctuations. Higher costs of natural gas will adversely affect our consolidated results if we are unable to effectively manage our exposure or pass these costs on to customers in the form of surcharges.

We are dependent on three paper mills for the fiber used in the manufacture of our fiber-based granular products. These mills have the exclusive right to supply the papermaking byproducts used in the manufacturing process. Due to process changes at the mills, we have experienced some difficulty obtaining sufficient raw material to operate at optimal production levels. We continue to work with the mills to ensure a stable supply of raw material. To date, we have been able to meet all of our customer delivery requirements, but there can be no assurance that we will be able to meet future delivery requirements. Although we believe our relationship with the mills is good, the mills could decide not to renew the contracts when they expire at the end of 2009, or may not agree to renew on commercially reasonable terms. If the mills were unable or unwilling to supply us sufficient fiber, we would be forced to find an alternative supply for this raw material. We may be unable to find an alternative supply on commercially reasonable terms or could incur excessive transportation costs if an alternative supplier were found, which would increase our manufacturing costs, and might prevent prices for our products from being competitive or require closure of the business.

Our inability to protect our intellectual property could have a material adverse effect on our business. In addition, third parties may claim that we infringe their intellectual property, and we could suffer significant litigation or licensing expense as a result.

We seek patent and trade secret protection for significant new technologies, products, and processes because of the length of time and expense associated with bringing new products through the development process and into the marketplace. We own numerous U.S. and foreign patents, and we intend to file additional applications, as appropriate, for patents covering our products. Patents may not be issued for any pending or future patent applications owned by or licensed to us, and the claims allowed under any issued patents may not be sufficiently broad to protect our technology. Any issued patents owned by or licensed to us may be challenged, invalidated, or circumvented, and the rights under these patents may not provide us with competitive advantages. In addition, competitors may design around our technology or develop competing technologies. Intellectual property rights may also be unavailable or limited in some foreign countries, which could make it easier for competitors to capture increased market share. We could incur substantial costs to defend ourselves in suits brought against us, including for alleged infringement of third party rights, or in suits in which we may assert our intellectual property rights against others. An unfavorable outcome of any such litigation could have a material adverse effect on our business and results of operations. In addition, as our patents expire, we rely on trade secrets and proprietary know-how to protect our products. We cannot be sure the steps we have taken or will take in the future will be adequate to deter misappropriation of our proprietary information and intellectual property. Of particular concern are developing economies such as China, where the laws, courts, and administrative agencies may not protect our intellectual property rights as fully as in other countries.

We seek to protect trade secrets and proprietary know-how, in part, through confidentiality agreements with our collaborators, employees, and consultants. These agreements may be breached, we may not have adequate remedies for any breach, and our trade secrets may otherwise become known or be independently developed by our competitors or our competitors may otherwise gain access to our intellectual property.

Fluctuations in our quarterly operating results may cause our stock price to decline.

Given the nature of the markets in which we participate and the impact of accounting standards related to revenue recognition, we may not be able to reliably predict future revenues and profitability, and unexpected changes may cause us to adjust our operations. A large proportion of our costs are fixed, due in part to our significant selling, research and development, and manufacturing costs. Thus, small declines in revenues could disproportionately affect our operating results. Other factors that could affect our quarterly operating results include:

- failure of our products to pass contractually agreed upon acceptance tests, which would delay or prohibit recognition of revenues under SAB No. 104,
- changes in the assumptions used for revenue recognized under the percentage-of-completion method of accounting,
- failure of a customer, particularly in China, to comply with an order s contractual obligations,
- adverse changes in demand for and market acceptance of our products,
- competitive pressures resulting in lower sales prices of our products,
- adverse changes in the pulp and paper industry,
- delays or problems in our introduction of new products,
- delays or problems in the manufacture of our products,
- our competitors announcements of new products, services, or technological innovations,
- contractual liabilities incurred by us related to guarantees of our product performance,

- increased costs of raw materials or supplies, including the cost of energy,
- changes in the timing of product orders, and
- fluctuations in our effective tax rate.

Anti-takeover provisions in our charter documents, under Delaware law, and in our shareholder rights plan could prevent or delay transactions that our shareholders may favor.

Provisions of our charter and bylaws may discourage, delay, or prevent a merger or acquisition that our shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares. For example, these provisions:

- authorize the issuance of blank check preferred stock without any need for action by shareholders,
- provide for a classified board of directors with staggered three-year terms,
- require supermajority shareholder voting to effect various amendments to our charter and bylaws,
- eliminate the ability of our shareholders to call special meetings of shareholders,
- prohibit shareholder action by written consent, and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by shareholders at shareholder meetings.

In addition, our board of directors has adopted a shareholder rights plan intended to protect shareholders in the event of an unfair or coercive offer to acquire our company and to provide our board of directors with adequate time to evaluate unsolicited offers. Preferred stock purchase rights have been distributed to our common shareholders pursuant to the rights plan. This rights plan may have anti-takeover effects. The rights plan will cause substantial dilution to a person or group that attempts to acquire us on terms that our board of directors does not believe are in our best interests and those of our shareholders and may discourage, delay, or prevent a merger or acquisition that shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We believe that our facilities are in good condition and are suitable and adequate for our present operations. We do not anticipate significant difficulty in obtaining lease renewals or alternative space as needed. The location and general character of our principal properties as of December 29, 2007, are as follows:

Papermaking Systems

We own approximately 1,855,000 square feet and lease approximately 129,000 square feet, under leases expiring on various dates ranging from 2008 to 2012, of manufacturing, engineering, and office space. In addition, in China we lease the land associated with our buildings under long-term leases, which expire on dates ranging from 2044 to 2054. Our principal engineering and manufacturing facilities are located in Vitry-le-Francois, France; Jining, China; Three Rivers, Michigan, U.S.A; Auburn, Massachusetts, U.S.A; Yangzhou, China; Theodore, Alabama, U.S.A; Queensbury, New York, U.S.A; Weesp, The Netherlands; Wuxi, China; Hindas, Sweden; Guadalajara, Mexico; Bury, England; Tengzhou, China; Summerstown, Ontario, Canada; Sao Paulo, Brazil; and Mason, Ohio, U.S.A.

Corporate and Other Businesses

We lease approximately 10,000 square feet in Westford, Massachusetts, for our corporate headquarters under a lease expiring in 2013. We own approximately 26,000 square feet of manufacturing and office space located in Green Bay, Wisconsin. We also lease approximately 25,000 square feet of manufacturing space located in Green Bay, Wisconsin, on a tenant-at-will basis.

Item 3. Legal Proceedings

We have been named as a co-defendant in a consumer class action lawsuit brought by Terrence Fisher, Joseph Jennings, Paula Moore, and Larry Boylen on behalf of a putative class of individuals who own GeoDeck decking or railing products manufactured by Composites LLC between April 2002 and October 2003. The complaint was filed in the United States District Court for the District of Massachusetts, Docket Number 1:07-CV-12375-JLT, on December 27, 2007 and notice was served on the Company on January 7, 2008. Other defendants are Kadant Composites LLC and Liberty Diversified Industries, Inc. The complaint in this matter purports to assert, among other things, causes of action for unfair and deceptive trade practices, fraud, negligence, breach of warranty and unjust enrichment, and it seeks unspecified compensatory damages and punitive damages under various state consumer protection statutes. In subsequent disclosures filed in this litigation, plaintiffs claim that such damages exceed $50 million. We intend to defend against this action vigorously, but there is no assurance we will prevail in such litigation. A judgment or a settlement of the claims against the defendants could have a material adverse impact on our consolidated financial results.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Market Price of Common Stock

Our common stock trades on the New York Stock Exchange under the symbol KAI.

The following table sets forth the high and low sales prices of our common stock for 2007 and 2006, as reported in the consolidated transaction reporting system.

	2007		2006	
Quarter	**High**	**Low**	**High**	**Low**
First	$ 27.79	$ 22.11	$ 23.32	$ 17.95
Second	31.70	24.47	27.10	20.70
Third	31.58	25.06	26.55	19.50
Fourth	33.76	26.85	27.98	22.79

Holders of Common Stock

As of February 29, 2008, we had approximately 4,993 holders of record of our common stock. This does not include holdings in street or nominee name. The closing market price on the New York Stock Exchange for our common stock on February 29, 2008, was $25.10 per share.

Dividend Policy

We have never declared or paid cash dividends and we do not at this time expect to pay cash dividends in the foreseeable future because our policy has been to use earnings to finance expansion and growth, as well as repurchase our stock. Payment of dividends will rest within the discretion of the board of directors and will depend upon, among other factors, our earnings, capital requirements, and financial condition. Our ability to pay dividends is restricted by the terms of our 2008 Credit Agreement.

Issuer Purchases of Equity Securities

The following table provides information about purchases by us of our common stock during the fourth quarter of 2007:

Issuer Purchases of Equity Securities

Period		Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans
9/30/07	10/31/07				$ 20,000,000
11/1/07	11/30/07				$ 20,000,000
12/1/07	12/29/07				$ 20,000,000
Total					

(1) On May 2, 2007, our board of directors approved the repurchase by us of up to $20 million of our equity securities during the period from May 2, 2007 through May 2, 2008. Repurchases may be made in public or private transactions, including under Securities Exchange Act Rule 10b-5-1 trading plans. As of December 29, 2007, no purchases had been made under this authorization.

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Item 6. Selected Financial Data

(In thousands, except per share amounts)	2007	2006 (a)	2005	2004 (b)	2003 (c)
Statement of Income Data					
Revenues	$ 366,496	$ 341,613	$ 243,713	$ 194,966	$ 191,507
Income from Continuing Operations	25,418	18,281	9,865	5,753	13,123
Loss from Discontinued Operation, Net of Tax	(2,750)	(1,184)	(2,988)	(5,099)	(1,306)
Net Income	$ 22,668	$ 17,097	$ 6,877	$ 654	$ 11,817
Basic Earnings per Share:					
Continuing Operations	$ 1.80	$ 1.32	$ .71	$ .41	$ .96
Discontinued Operation	(.19)	(.08)	(.21)	(.36)	(.09)
Net Income	$ 1.61	$ 1.24	$ .50	$ .05	$ .87
Diluted Earnings per Share:					
Continuing Operations	$ 1.78	$ 1.30	$ .70	$ .40	$ .94
Discontinued Operation	(.19)	(.09)	(.21)	(.35)	(.09)
Net Income	$ 1.59	$ 1.21	$ .49	$ .05	$ .85
Balance Sheet Data (d)					
Working Capital (e)	$ 107,487	$ 80,542	$ 75,446	$ 113,650	$ 114,935
Total Assets	437,069	393,085	355,811	285,237	271,713
Long-Term Obligations	30,460	44,652	46,500		
Shareholders Investment	278,751	237,965	207,625	212,461	211,758

(a) Reflects $0.8 million of pre-tax restructuring costs.
(b) Reflects $9.5 million of pre-tax restructuring costs.
(c) Restated to reflect the composite building products business as a discontinued operation.
(d) Includes the composite building products business, which is reflected as a discontinued operation.
(e) Includes ($1.1) million, $3.0 million, $7.4 million, $8.1 million, and $12.2 million in 2007, 2006, 2005, 2004, and 2003, respectively, associated with the discontinued operation.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Reference is made throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations to Notes included in the Consolidated Financial Statements, beginning on page F-1 of this Report.

Overview

Company Overview

We are a leading supplier of equipment used in the global papermaking and paper recycling industries and are also a manufacturer of granules made from papermaking byproducts. Our continuing operations are comprised of one reportable operating segment: Pulp and Papermaking Systems (Papermaking Systems), and two product lines reported in Other Businesses, which include Fiber-based Products and, prior to its sale in April 2007, Casting Products. Through our Papermaking Systems segment, we develop, manufacture, and market a range of equipment and products for the global papermaking and paper recycling industries. We have a large, stable customer base that includes most of the world s major paper manufacturers. We believe our large installed base provides us with a spare parts and consumables business that yields higher margins than our capital equipment business, and which should be less susceptible to the cyclical trends in the paper industry.

Through our Fiber-based Products line, we manufacture and sell granules derived from pulp fiber for use as carriers for agricultural, home lawn and garden, and professional lawn, turf and ornamental applications, as well as for oil and grease absorption. Our Casting Products business manufactured grey and ductile iron castings until its sale on April 30, 2007.

In addition, prior to its sale on October 21, 2005, we operated a composite building products business, which is presented as a discontinued operation in the accompanying consolidated financial statements.

International Sales

During 2007 and 2006, approximately 61% of our sales were to customers outside the United States, principally in China and Europe. We generally seek to charge our customers in the same currency in which our operating costs are incurred. However, our financial performance and competitive position can be affected by currency exchange rate fluctuations affecting the relationship between the U.S. dollar and foreign currencies. We seek to reduce our exposure to currency fluctuations through the use of forward currency exchange contracts. We may enter into forward contracts to hedge certain firm purchase and sale commitments denominated in currencies other than our subsidiaries functional currencies. These contracts hedge transactions principally denominated in U.S. dollars.

Application of Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Our actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that entail significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies upon which our financial position depends, and which involve the most complex or subjective decisions or assessments, are those described below. For a discussion on the application of these and other accounting policies, see Note 1 in the Notes to Consolidated Financial Statements.

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Revenue Recognition and Accounts Receivable. We enter into arrangements with customers that have multiple deliverables, such as equipment and installation, and we recognize revenues and profits on certain long-term contracts using the percentage-of-completion method of accounting.

Percentage-of-Completion. Revenues recorded under the percentage-of-completion method of accounting pursuant to Statement of Position No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, were $103.5 million in 2007, $91.9 million in 2006, and $55.6 million in 2005. The percentage of completion is determined by comparing the actual costs incurred to date to an estimate of total costs to be incurred on each contract. If a loss is indicated on any contract in process, a provision is made currently for the entire loss. Our contracts generally provide for billing of customers upon the attainment of certain milestones specified in each contract. Revenues earned on contracts in process in excess of billings are classified as unbilled contract costs and fees, and amounts billed in excess of revenues are classified as billings in excess of contract costs and fees. The estimation process under the percentage-of-completion method affects the amounts reported in our consolidated financial statements. A number of internal and external factors affect our percentage-of-completion and cost of sales estimates, including labor rate and efficiency variances, estimates of warranty costs, estimated future material prices from vendors, and customer specification and testing requirements. In addition, we are exposed to the risk, primarily relating to our orders in China that a customer will not comply with the order s contractual obligations to take delivery of the equipment. The contractual obligations relating to the order may be difficult to enforce through a foreign country s legal system, which could result in a significant credit exposure in the period or periods that were to be affected by the breach of contract. Although we make every effort to ensure the accuracy of our estimates in the application of this accounting policy, if our actual results differed from our estimates, or if we were to use different assumptions, it is possible that materially different amounts could be reported as revenues in our consolidated financial statements.

SAB No. 104. Under SAB No. 104, Revenue Recognition, when the terms of sale include customer acceptance provisions, and compliance with those provisions cannot be demonstrated until customer acceptance, revenues are recognized upon such acceptance. When a sale arrangement involves multiple elements (e.g., installation), we consider the guidance in Emerging Issues Task Force (EITF) No. 00-21 Revenue Arrangements with Multiple Deliverables. Such transactions are evaluated to determine whether the deliverables in the arrangement represent separate units of accounting. If equipment and installation do not meet the separation criteria under EITF No. 00-21, revenues for products sold that require installation, for which the installation is essential to functionality or is not deemed inconsequential or perfunctory, are recognized upon completion of installation. Revenues for products sold where installation is not essential to functionality, and is deemed inconsequential or perfunctory, are recognized upon shipment, with estimated installation costs accrued. We provide a reserve for the estimated warranty and installation costs at the time revenue is recognized, as applicable. To the extent that installation becomes a significant component of our business in the future, the judgment associated with the determination of revenue recognition will increase. The complexity of all issues related to the assumptions, risks, and uncertainties inherent in the application of SAB No. 104 affects the amounts reported as revenues in our consolidated financial statements. Under SAB No. 104, we may not be able to reliably predict future revenues and profitability due to the difficulty of estimating when installation will be performed or when we will meet the contractually agreed upon performance tests, which can delay or prohibit recognition of revenues. The determination of when we install the equipment or fulfill the performance guarantees is largely dependent on our customers, their willingness to allow installation of the equipment or performance of the appropriate tests in a timely manner, and their cooperation in addressing possible problems that would impede achievement of the performance guarantee criteria. Unexpected changes in the timing related to the completion of installation or performance guarantees could cause our revenues and earnings to be significantly affected.

We exercise judgment in determining our allowance for bad debts, which is based on our historical collection experience, current trends, credit policies, specific customer collection issues, and accounts receivable aging categories. In determining this allowance, we look at historical write offs of our receivables. We also look at current trends in the credit quality of our customer base as well as changes in our credit policies. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and each customer s current creditworthiness. We continuously monitor collections and payments from our customers. In addition, in some instances we utilize letters of credit as a way to mitigate credit exposure. While actual bad debts have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same rate of bad debts that we have in the past, especially in light of business conditions in the paper industry. A significant change in the liquidity or financial position of any of our customers could result in the uncollectibility of the related accounts receivable and could adversely affect our operating results and cash flows in that period.

Warranty Obligations for Continuing Operations. We offer warranties of various durations to our customers depending upon the specific product and terms of the customer purchase agreement. We typically negotiate terms regarding warranty coverage and length of warranty depending on the products and their applications. Our standard mechanical warranties require us to repair or replace a defective product during the warranty period at no cost to the customer. We record an estimate for warranty-related costs at the time of sale based on our actual historical occurrence rates and repair costs, as well as other analytical tools for estimating future warranty claims. These estimates are revised for variances between actual and expected claims rates. While our warranty costs have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same warranty return rates or repair costs that we have in the past.

A significant increase in warranty occurrence rates or costs to repair our products would lead to an increase in the warranty provision and could have a material adverse impact on our consolidated results for the period or periods in which such returns or additional costs occur.

Warranty Obligations for Discontinued Operation. On October 21, 2005, our Kadant Composites LLC subsidiary (Composites LLC) sold substantially all of its assets to LDI Composites Co. for approximately $11.9 million in cash and the assumption of $0.7 million of liabilities, resulting in a cumulative loss on sale of $0.1 million. Under the terms of the asset purchase agreement, Composites LLC retained certain liabilities associated with the operation of the business prior to the sale, including warranty obligations related to products manufactured prior to the sale date. All activity related to this business is classified in the results of the discontinued operation in the accompanying consolidated financial statements.

Through the second quarter of 2006, Composites LLC recorded an estimate for warranty-related costs at the time of sale based on its actual historical return rates and repair costs, as well as other analytical tools for estimating future warranty claims. These estimates were revised for variances between actual and expected claims rates. Composites LLC s analysis of expected warranty claims rates included detailed assumptions associated with potential product returns, including the type of product sold, temperatures at the location of installation, density of boards, and other factors. Certain assumptions, such as the effect of weather conditions and high temperatures on the product installed, included inherent uncertainties that contributed to variances between actual and expected claims rates.

During the third quarter of 2006, Composites LLC concluded that the assumptions noted above were not accurately predicting the actual level of warranty claims, making it no longer possible to calculate a reasonable estimate of the future level of potential warranty claims. Accordingly, as no amount within the total range of loss represents a best estimate of the ultimate loss to be recorded, Composites LLC is required under SFAS 5 to record the minimum amount of the potential range of loss for products under warranty. As of December 29, 2007, the accrued warranty costs associated with the composites business were $2.1 million, which represent the low end of the range of potential loss for products under warranty based on the level of claims received through the end of 2007. Composites LLC has calculated that the potential warranty cost ranges from $2.1 million to approximately $13.1 million. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty.

Composites LLC retained all of the cash proceeds received from the asset sale and continued to administer and pay warranty claims from the sale proceeds into the third quarter of 2007. On September 30, 2007, Composites LLC announced that it no longer had sufficient funds to honor warranty claims, was unable to pay or process warranty claims, and ceased doing business. Composites LLC will continue to record adjustments to accrued warranty costs to reflect the minimum amount of the potential range of loss for products under warranty based on judgments entered against it in litigation.

Stock-Based Compensation. We issue a variety of stock-based compensation, including stock options and restricted stock unit awards, primarily to our key employees and directors. Compensation expense associated with restricted stock units is recognized ratably over the vesting period based on the grant date fair value.

On January 1, 2006, we adopted SFAS No. 123, Share Based Payment (SFAS 123R), which requires that we recognize stock-based compensation expense associated with stock options in the statement of income, rather than disclose it in a pro forma footnote to our consolidated financial statements. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We did not grant any stock options in 2007 and 2006. For options granted prior to January 1, 2006, we calculated the grant-date fair values using the Black-Scholes valuation model. The use of valuation models requires us to make estimates of the following assumptions:

Expected volatility We derived the estimated stock price volatility based on a review of our actual historic stock prices commensurate with the expected life of the award.

Expected option life Our estimate of an expected option life was derived based on a review of our historic option holding periods, including a consideration of the holding period inherent in currently vested, but unexercised options. We believe that this historical data is currently the best estimate of the expected term of a new option.

Risk-free interest rate We used the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption as the risk-free interest rate.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered option. Similar to the analysis for the expected option life, we reviewed historical forfeiture data and have applied an annual forfeiture rate of 2.5% to all unvested options as of December 31, 2005. We reevaluate this analysis quarterly and adjust the forfeiture rate as necessary. Ultimately, we will recognize the actual expense over the vesting period only for the shares that vest.

Income Taxes. We estimate the degree to which tax assets and loss carryforwards will result in a benefit based on expected profitability by tax jurisdiction, and provide a valuation allowance for tax assets and loss carryforwards that we believe will more likely than not go unused. If it becomes more likely than not the tax asset or loss carryforward will be used, we would reverse the related valuation allowance. Our tax valuation allowance totaled $2.7 million at year-end 2007. Should our actual future taxable income by tax jurisdiction vary from our estimate, additional allowances or reversals thereof may be necessary.

We provide a liability for future income tax payments in the worldwide tax jurisdictions in which we operate. Should tax return positions that we expect are sustainable not be sustained upon audit, we could be required to record an incremental tax provision for such taxes. Should previously unrecognized tax benefits be sustained, a reduction in our tax provision would result.

It is our policy to provide for uncertain tax positions and the related interest and penalties based upon management s assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. At December 29, 2007, we believe that we have appropriately accounted for any unrecognized tax benefits. To the extent we prevail in matters for which a liability for an unrecognized tax benefit is established or are required to pay amounts in excess of the liability, our effective tax rate in a given financial statement period may be affected.

Inventories. We value our inventory at the lower of the actual cost (on a first-in, first-out; or weighted average basis) or market value and include materials, labor, and manufacturing overhead. We regularly review

inventory quantities on hand and compare these amounts to historical and forecasted usage of and demand for each particular product or product line. We record a charge to cost of revenues for excess and obsolete inventory to reduce the carrying value of the inventories to net realizable value. Inventory writedowns have historically been within our expectations and the provisions established. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand, resulting in a charge for the writedown of that inventory in that period. In addition, our estimates of future product usage or demand may prove to be inaccurate, resulting in an understated or overstated provision for excess and obsolete inventory. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product usage and demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results.

In the fourth quarter of 2007, we changed our method of accounting for inventories at one of our U.S. subsidiaries from the lower of cost, as determined by the last-in, first-out (LIFO) method of accounting, or market to the lower of cost, as determined by the first-in, first-out (FIFO) method of accounting, or market. We believe that this change is preferable because: 1) the change conforms to a single method of accounting for all our inventories, 2) LIFO inventory values have not been materially different than FIFO inventory values for any reporting period, and 3) the majority of our competitors use FIFO. Had we used FIFO instead of LIFO for each reporting period for this U.S. subsidiary since its acquisition in 2005, the difference between the LIFO and FIFO valuation methods and their resulting effects on the consolidated financial statements, would not have been material for each such period. As a result, we recorded the cumulative change from the LIFO to the FIFO method of accounting in the fourth quarter of 2007.

Derivatives. We use derivative instruments primarily to reduce our exposure to changes in currency exchange rates and interest rates. When we enter into a derivative contract, we make a determination as to whether the transaction is deemed to be a hedge for accounting purposes. For contracts deemed to be a hedge, we formally document the relationship between the derivative instrument and the risk being hedged. In this documentation, we specifically identify the asset, liability, forecasted transaction, cash flow, or net investment that has been designated as the hedged item, and evaluate whether the derivative instrument is expected to reduce the risks associated with the hedged item. To the extent these criteria are not met, we do not use hedge accounting for the derivative.

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, requires that all derivatives be recognized on the balance sheet at fair value. For derivatives designated as cash flow hedges, the related gains or losses on these contracts are deferred as a component of accumulated other comprehensive items. These deferred gains and losses are recognized in the period in which the underlying anticipated transaction occurs. For derivatives designated as fair value hedges, the unrealized gains and losses resulting from the impact of currency exchange rate movements are recognized in earnings in the period in which the exchange rates change and offset the currency gains and losses on the underlying exposures being hedged. We perform an evaluation of the effectiveness of the hedge both at inception and on an ongoing basis. The ineffective portion of a hedge, if any, and changes in the fair value of a derivative not deemed to be a hedge, are recorded in the consolidated statement of income.

We use interest rate swap agreements to hedge our exposure to variable rate debt and have designated these agreements as cash flow hedges of the forecasted interest payments related to these obligations. The fair value of the interest rate swap agreements are included in other assets for unrecognized gains and in other liabilities for unrecognized losses with an offset in accumulated other comprehensive items (net of tax).

We use forward currency exchange contracts primarily to hedge certain operational (cash flow hedges) and balance sheet (fair value hedges) exposures resulting from fluctuations in currency exchange rates. Such exposures primarily result from portions of our operations and assets that are denominated in currencies other than the functional currencies of the businesses conducting the operations or holding the assets. We enter into forward currency exchange contracts to hedge anticipated product sales and recorded accounts receivable made in the normal course of business, and accordingly, the hedges are not speculative in nature.

Valuation of Goodwill and Intangible Assets. We evaluate the recoverability of goodwill and indefinite-lived intangible assets annually in the fourth quarter, or more frequently if events or changes in circumstances, such as a decline in sales, earnings, or cash flows, or material adverse changes in the business climate, indicate that the carrying value of an asset might be impaired. We completed our annual impairment tests in the fourth quarter of 2007 using estimates from our long-range forecasts. Intangible assets subject to amortization are evaluated for impairment if events or changes in circumstances indicate that the carrying value of an asset might be impaired. No adjustment was required in 2007 to the carrying value of our goodwill or intangible assets based on the analysis performed.

Goodwill is considered to be impaired when the net book value of a reporting unit exceeds its estimated fair value. Fair values are primarily established using a discounted cash flow methodology (specifically, the income approach). The determination of discounted cash flows is based on our long-range forecasts. The revenue growth rates included in the forecasts are our best estimates based on current and anticipated market conditions, and the profit margin assumptions are projected based on current and anticipated cost structures. Our judgments and assumptions regarding the determination of the fair value of an intangible asset or goodwill associated with an acquired business could change as future events impact such fair values. Any future impairment loss could have a material adverse affect on our long-term assets and operating expenses in the period in which impairment is determined to exist.

Industry and Business Outlook

Our products are primarily sold to the global pulp and paper industry. The paper industry in North America and Europe has been in a prolonged down cycle for the past several years and has undergone important structural changes during that time. In contrast, the paper industry in China has experienced strong growth over the last several years. The performance of paper producers in North America and Europe had generally improved over the past year. However, paper producers in those regions continue to be negatively affected by higher operating costs, especially higher energy and chemical costs. We believe paper companies are still cautious about increasing their capital and operating spending in the current market environment. As the financial performance of paper companies has improved, they have increased their capital and operating spending, which has had a positive effect on paper company suppliers, including us. We continue to concentrate our efforts on several initiatives intended to improve our operating results, including: increasing sales of paper machine accessories and water-management products in China, increasing our use of low-cost manufacturing bases in China and Mexico, penetrating new markets outside the paper industry, and increasing aftermarket sales, especially in China. In addition, we continue to focus our efforts on managing our operating costs, capital expenditures, and working capital.

On May 11, 2005, we acquired all the outstanding stock of The Johnson Corporation (Kadant Johnson), a leading supplier of fluid-handling systems and equipment, including steam and condensate systems, components, and controls. These products are used primarily in the dryer section of the papermaking process and in the production of corrugated boxboard, metals, plastics, rubber, textiles, and food. Kadant Johnson was a privately held company based in Three Rivers, Michigan, with approximately 575 employees.

On June 2, 2006, Kadant Jining, assumed responsibility for the operation of Huayi and, by September 30, 2006, acquired the assets of Huayi, including cash, inventory, machinery, equipment, and buildings (Kadant Jining acquisition). Huayi was a supplier of stock-preparation equipment in China.

In the last several years, China has become a significant market for our stock-preparation equipment. A large percentage of the world s increases in paper production capacity are in China. Consequently, competition is intense and there is increasing pricing pressure particularly for large systems. To capitalize on this growing market, we started manufacturing certain of our accessory and water-management products in our China facilities in 2007. Currently, our revenues from China are primarily derived from large capital orders, the timing of which is often difficult to predict. At times, our customers in China have experienced delays in obtaining financing for their capital addition and expansion projects due to efforts by the Chinese government to control economic growth, which are reflected in a slowdown in financing approvals in China s banking system. These delays, as well as, delays in receiving down payments, could cause us to recognize revenue on these projects in periods later than originally anticipated. We plan to use Kadant Jining as a base for increasing our aftermarket business, which we believe will be more predictable.

For 2008, we expect revenues and earnings per share from continuing operations, which exclude the results from our discontinued operation, as follows: For the first quarter of 2008, we expect to earn between $.30 and $.32 per diluted share, including a $.02 gain on the sale of assets, on revenues of $88 to $90 million. For the full year, we expect to earn between $1.85 and $1.90 per diluted share on revenues of $385 to $395 million.

Results of Operations

2007 Compared to 2006

The following table sets forth our consolidated statement of income expressed as a percentage of total revenue:

	2007	2006
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	62	63
Selling, general, and administrative expenses	26	26
Research and development expenses	2	2
Loss on sale of subsidiary		
Restructuring costs (income), net		
	90	91
Operating Income	10	9
Interest Income	1	
Interest Expense	(1)	(1)
Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense	10	8
Provision for Income Taxes	3	3
Minority Interest Expense		
Income from Continuing Operations	7	5
Loss from Discontinued Operation	(1)	
Net Income	6%	5%

Revenues

Revenues increased $24.9 million, or 7%, to $366.5 million in 2007 from $341.6 million in 2006, including a $13.0 million increase from the favorable effects of currency translation. Excluding the effects of currency translation, revenues in 2007 increased primarily due to a $14.9 million, or 10%, increase from stock-preparation equipment sales due to higher capital equipment sales and a $4.6 million, or 5%, increase in our fluid-handling product line due in part to increased demand caused by higher energy prices. Offsetting these increases, excluding the favorable effects of currency translation, was a $3.4 million, or 10%, decrease in revenues in our water-management product line due to lower capital equipment sales, a $2.5 million, or 63%, decrease in revenues in our Casting Products business due to the sale of this business in April 2007, and a $1.4 million, or 14%, decrease in revenues in our Fiber-based Products business.

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Revenues for 2007 and 2006 for our Papermaking Systems segment and other businesses are as follows:

(In thousands)	2007	2006
Revenues:		
Papermaking Systems	$ 356,334	$ 327,501
Other Businesses	10,162	14,112
	$ 366,496	$ 341,613

Papermaking Systems Segment. Revenues at the Papermaking Systems segment increased $28.8 million, or 9%, to $356.3 million in 2007 from $327.5 million in 2006. The increase in revenues in 2007 was primarily due to a $16.1 million, or 34%, increase in our stock-preparation equipment sales in North America and a $13.0 million increase from the favorable effects of currency translation.

The following table presents revenues at the Papermaking Systems segment by product line, the changes in revenues by product line between 2007 and 2006, and the changes in revenues by product line between 2007 and 2006, excluding the effect of currency translation. The presentation of the changes in revenues by product line, excluding the effect of currency translation, is a non-GAAP (generally accepted accounting principles) measure. We believe this non-GAAP measure helps investors gain a better understanding of our underlying operations, consistent with how management measures and forecasts our performance, especially when comparing such results to prior periods.

(In millions)	2007	2006	Increase (Decrease)	Increase (Decrease) Excluding Effect of Currency Translation
Papermaking Systems Product Lines:				
Stock-Preparation Equipment	$ 165.8	$ 146.2	$ 19.6	$ 15.0
Fluid-Handling	94.0	84.4	9.6	4.6
Accessories	63.1	60.6	2.5	(0.2)
Water-Management	31.1	33.8	(2.7)	(3.4)
Other	2.3	2.5	(0.2)	(0.2)
	$ 356.3	$ 327.5	$ 28.8	$ 15.8

Revenues from the segment s stock-preparation equipment product line increased $19.6 million, or 13%, in 2007 compared to 2006, including a $4.6 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues in 2007 increased $15.0 million, or 10%, primarily due to a $16.1 million, or 34%, increase in demand for stock-preparation equipment in North America due to increased demand, offset, in part, by a $2.6 million decrease from sales in Europe.

Revenues from the segment s fluid-handling product line increased $9.6 million, or 11%, in 2007 compared to 2006, including a $5.0 million increase from the favorable effect of currency translation. Excluding the effect of currency translation, revenues increased $4.6 million, or 5%, in 2007 due in part to increased demand caused by higher energy prices.

Revenues from the segment s accessories product line increased $2.5 million, or 4%, in 2007 compared to 2006, including a $2.7 million increase from the favorable effect of currency transaction. Excluding the effect of currency translation, revenues decreased $0.2 million in 2007 compared to 2006.

Revenues from the segment s water-management product line decreased $2.7 million, or 8%, in 2007 compared to 2006, including a $0.7 million increase from the favorable effect of currency transaction. Excluding the effect of currency translation, revenues decreased $3.4 million, or 10%, in 2007 due primarily to a decrease in capital sales.

Other Businesses. Revenues from our other businesses decreased $3.9 million, or 28%, to $10.2 million in 2007 from $14.1 million in 2006. Revenues from our Casting Products business decreased $2.5 million, or 63%, to $1.5 million in 2007 compared to $4.0 million in 2006 due to its sale in April 2007. Revenues from the Fiber-based Products business decreased $1.4 million, or 14%, to $8.7 million in 2007 from $10.1 million in 2006 due to increased competition which decreased sales of our fiber-based granules products sold under the tradename Biodac .

Gross Profit Margin

Gross profit margin for 2007 and 2006 for our Papermaking Systems segment and our other businesses are as follows:

	2007	**2006**
Gross Profit Margin:		
Papermaking Systems	38%	37%
Other Businesses	32%	28%
	38%	37%

Gross profit margin was 38% and 37% in 2007 and 2006, respectively. The gross profit margin at the Papermaking Systems segment increased to 38% in 2007 from 37% in 2006. The gross profit margin at our other businesses increased to 32% in 2007 from 28% in 2006 due to the sale of our lower-margin Casting Products business in April 2007.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues were 26% in 2007 and 2006. Selling, general, and administrative expenses increased $5.4 million, or 6%, to $95.6 million in 2007 from $90.2 million in 2006. This increase was primarily due to a $3.5 million unfavorable effect of currency translation and a $0.9 million increase in stock-based compensation expense due primarily to the grant of restricted stock units in May 2007.

Research and development expenses decreased $0.2 million, or 4%, to $6.0 million in 2007 from $6.2 million in 2006 and represented 2% of revenues in both periods.

Total stock-based compensation expense was $1.8 million and $0.9 million in 2007 and 2006, respectively, and is included in selling, general, and administrative expenses. As of year-end 2007, unrecognized compensation cost related to stock options and restricted stock awards was approximately $4.4 million, which will be recognized over a weighted average period of 2.5 years.

Loss on Sale of Subsidiary

In April 2007, our Kadant Johnson Holdings Inc. (formerly Specialty Castings Inc.) subsidiary sold its Casting Products business for $0.4 million, resulting in a pre-tax loss of $0.4 million on the sale.

Restructuring Costs (Income), Net

During 2007, we recorded net restructuring income in our Papermaking Systems segment of $0.2 million, which included restructuring costs of $0.3 million related to exiting a facility and restructuring income of $0.5 million related to a reduction in the restructuring reserve as the reserve was no longer required.

During 2006, we recorded restructuring costs in our Papermaking Systems segment of $0.8 million, which included $0.7 million of severance and associated costs due to a reduction of 15 full-time employees in Canada and France and $0.1 million of equipment relocation costs associated with our 2005 restructuring actions.

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Interest Income

Interest income increased $0.5 million, or 40%, to $1.6 million in 2007 from $1.1 million in 2006 primarily due to higher prevailing interest rates.

Interest Expense

Interest expense decreased $0.2 million, or 7%, to $3.1 million in 2007 from $3.3 million in 2006 primarily due to lower average outstanding borrowings as a result of a prepayment of $7.8 million of debt in May 2006.

Provision for Income Taxes

Our effective tax rate was 28% and 32% in 2007 and 2006, respectively. The 28% effective tax rate in 2007 consisted of our 30% recurring tax rate, offset by 2% of non-recurring tax benefit related to reductions in tax reserves largely as a result of the expiration of statues of limitation and return to provision true-up items mostly related to the U.S. tax cost of foreign earnings. The 32% effective tax rate in 2006 consisted of our 33% recurring tax rate, slightly offset by a 1% non-recurring tax benefit related to reductions in tax reserves associated with the favorable resolution of a state tax audit. We saw a 3% decrease in our recurring tax rate from 2006 to 2007 primarily due to a favorable geographical distribution of earnings and a reduction in nondeductible expenses. We expect our effective tax rate to be approximately 30% in 2008 due to the continuation of a favorable geographical distribution of earnings.

Income from Continuing Operations

Income from continuing operations increased $7.1 million, or 39%, to $25.4 million in 2007 from $18.3 million in 2006. The increase in 2007 was primarily due to a $24.9 million, or 7%, increase in revenues which contributed to an increase in operating income of $7.6 million (see *Revenues*, *Gross Profit Margin* and *Operating Expenses* discussed above).

Loss from Discontinued Operation

The net loss from our discontinued operation increased $1.6 million, or 132%, to $2.8 million in 2007 from $1.2 million in 2006 due primarily to a $2.7 million pre-tax increase in warranty costs.

As of December 29, 2007, the accrued warranty costs associated with the composites business were $2.1 million, which represents the low end of the estimated range of warranty reserve required based on the level of claims received through the end of 2007. Composites LLC has calculated that the total potential warranty cost ranges from $2.1 million to approximately $13.1 million. The high end of the range represents the estimated maximum level of warranty claims remaining based on the total sales of the products under warranty.

Composites LLC retained all of the cash proceeds received from the asset sale in October 2005 and continued to administer and pay warranty claims from the sale proceeds into the third quarter of 2007. On September 30, 2007, Composites LLC announced that it no longer had sufficient funds to honor warranty claims, was unable to pay or process warranty claims, and ceased doing business. Composites LLC will continue to record adjustments to accrued warranty costs to reflect the minimum amount of the potential range of loss for products under warranty based on judgments entered against it in litigation. Our consolidated results in future reporting periods will be negatively impacted if the future level of warranty claims exceed the warranty reserve.

2006 Compared to 2005

The following table sets forth our consolidated statement of income expressed as a percentage of total revenue:

	2006	2005
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	63	61
Selling, general, and administrative expenses	26	31
Research and development expenses	2	2
Restructuring and other costs (income), net		
	91	94
Operating Income	9	6
Interest Income		1
Interest Expense	(1)	(1)
Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense	8	6
Provision for Income Taxes	3	2
Minority Interest Expense		
Income from Continuing Operations	5	4
Loss from Discontinued Operation		(1)
Net Income	5%	3%

Revenues

Revenues increased $97.9 million, or 40%, to $341.6 million in 2006 from $243.7 million in 2005. Revenues in 2006 increased primarily due to a $40.4 million, or 84%, increase from Kadant Johnson acquired in May 2005, a $39.4 million, or 165%, increase in stock-preparation equipment sales in China, which includes a $6.0 million increase from Kadant Jining acquired in June 2006. Also contributing to the increase in 2006 was a $2.8 million increase for an additional month of revenue recognized at our Kadant Lamort subsidiary to conform to our fiscal year end and a $2.6 million increase from the favorable effects of currency translation.

Revenues for 2006 and 2005 for our Papermaking Systems segment and other businesses are as follows:

(In thousands)	2006	2005
Revenues:		
Papermaking Systems	$ 327,501	$ 232,615
Other Businesses	14,112	11,098
	$ 341,613	$ 243,713

Papermaking Systems Segment. Revenues at the Papermaking Systems segment increased $94.9 million, or 41%, to $327.5 million in 2006 from $232.6 million in 2005. The increase in revenues in 2006 was primarily due to a $38.9 million, or 85%, increase in revenues from Kadant

Johnson acquired in May 2005, and a $39.4 million, or 165%, increase in stock-preparation equipment sales in China, which includes a $6.0 million increase from Kadant Jining acquired in June 2006. Also contributing to the increase in 2006 was a $2.8 million increase for an additional month of revenue recognized at our Kadant Lamort subsidiary to conform to our fiscal year end and a $2.6 million increase from the favorable effects of currency translation.

The following table presents revenues at the Papermaking Systems segment by product line, the changes in revenues by product line between 2006 and 2005, and the changes in revenues by product line between 2006 and 2005 excluding the effect of currency translation. The presentation of the changes in revenues by product line, excluding the effect of currency translation, is a non-GAAP (generally accepted accounting principles) measure. We believe this non-GAAP measure helps investors gain a better understanding of our underlying operations, consistent with how management measures and forecasts our performance, especially when comparing such results to prior periods.

(In millions)	2006	2005	Increase	Increase Excluding Effect of Currency Translation
Papermaking System Product Lines:				
Stock-Preparation Equipment	$ 146.2	$ 98.2	$ 48.0	$ 48.2
Fluid-Handling	84.4	45.5	38.9	36.9
Accessories	60.6	58.8	1.8	1.2
Water-Management	33.8	28.3	5.5	5.3
Other	2.5	1.8	0.7	0.7
	$ 327.5	$ 232.6	$ 94.9	$ 92.3

Revenues from the segment s stock-preparation equipment product line increased $48.0 million, or 49%, in 2006 compared to 2005, including a $0.2 million decrease from the unfavorable effect of currency translation. The increase was primarily due to a $39.4 million, or 165%, increase in capital equipment sales in China which includes a $6.0 million increase from Kadant Jining acquired in June 2006. In addition, revenues in this product line increased $4.6 million, or 15%, in 2006 at our European-based business primarily due to an increase in sales of both capital and aftermarket products and the inclusion of an additional month of revenue at our Kadant Lamort subsidiary to conform to our fiscal year end. Revenues in this product line also increased $4.0 million, or 9%, from sales in North America primarily due to stronger sales of both capital and aftermarket products.

Revenues from the segment s fluid-handling product line increased $38.9 million, or 85%, in 2006 compared to 2005, including a $2.0 million increase from the favorable effect of currency translation. This increase was primarily due to the inclusion of revenues from Kadant Johnson for the full 2006 period compared to their inclusion from May 11, 2005 in the prior year period.

Revenues from the segment s accessories product line increased $1.8 million, or 3%, in 2006 compared to 2005 primarily due to an increase in sales in Europe.

Revenues from the segment s water-management product line increased $5.5 million, or 19%, in 2006 compared to 2005, due primarily to an increase in capital sales in North America and, to a lesser extent, in Europe.

Other Businesses. Revenues from our other businesses increased $3.0 million, or 27%, to $14.1 million in 2006 from $11.1 million in 2005. Revenues from the Fiber-based Products business increased $1.5 million, or 18%, to $10.1 million in 2006 from $8.6 million in 2005 due to increased sales of our Biodac products. Revenues from our Casting Products business increased $1.5 million, or 60%, to $4.0 million in 2006 compared to $2.5 million in 2005 due to the inclusion of revenues from Kadant Johnson for the entire 2006 period compared to their inclusion from May 11, 2005 in the prior year period.

Gross Profit Margin

Gross profit margin for 2006 and 2005 for our Papermaking Systems segment and our other businesses are as follows:

	2006	2005
Gross Profit Margin:		
Papermaking Systems	37%	39%
Other Businesses	28%	28%
	37%	39%

Gross profit margin was 37% and 39% in 2006 and 2005, respectively. The gross profit margin at the Papermaking Systems segment decreased to 37% in 2006 from 39% in 2005. This decrease was primarily due to lower margins in our stock-preparation equipment product line as a result of several large capital equipment orders from China, which had lower than normal gross profit margin levels. Also contributing to the decrease was an unfavorable product mix that shifted toward lower-margin capital products. Partially offsetting this were improved gross margins at our fluid-handling product line. The gross profit margin at our other businesses was 28% in 2006 and 2005.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues decreased to 26% in 2006 from 31% in 2005 primarily due to higher operating leverage associated with increased revenues. Selling, general, and administrative expenses increased to $90.2 million in 2006 from $74.6 million in 2005, an increase of $15.6 million, or 21%. This increase was primarily due to a $9.7 million, or 51%, increase from Kadant Johnson resulting from its inclusion for the full 2006 period compared to its inclusion from May 11, 2005 in the prior year period. Also contributing to the increase was a $1.5 million increase from our Kadant Jining subsidiary acquired in June 2006, a $1.4 million increase from our Kadant Lamort subsidiary due to the inclusion of an additional month of selling, general, and administrative expenses to conform to our fiscal year end and a $0.8 million unfavorable effect of currency translation.

Research and development expenses increased to $6.2 million in 2006 from $4.9 million in 2005, an increase of $1.3 million, or 27%, and represented 2% of revenues in both periods. The increase in research and development expenses was primarily due to a $0.7 million increase from Kadant Johnson resulting from its inclusion for the full 2006 period compared to its inclusion from May 11, 2005 in the prior year period.

On January 1, 2006, we adopted SFAS 123R using the modified prospective method. There were no stock option awards granted in 2006. For stock option awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, SFAS 123R under the modified prospective method allowed us to recognize compensation cost beginning with the effective date based on the requirements of SFAS 123. For these stock option awards, we calculated compensation cost on the date of grant using the fair value of the stock options as determined by the Black-Scholes valuation model. In 2006, we recognized $0.3 million of pre-tax stock-based compensation expense, or $.01 per diluted share, related to unvested stock option awards granted prior to 2006 as a result of the adoption of SFAS 123R. Prior to the adoption of SFAS 123R, we accounted for share based payments to employees using Accounting Principles Board Opinion No. 25 s (APB 25), Accounting for Stock Issued to Employees, intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. As of December 30, 2006, the total compensation cost related to unvested stock option awards not yet recognized in the consolidated statement of income was approximately $0.1 million, which will be recognized over a weighted average period of 1.2 years. Under the modified prospective method, prior periods are not restated for the effect of SFAS 123R.

Total stock-based compensation expense, including compensation expense associated with restricted stock and the employee stock purchase plan, was $0.9 million and $0.3 million in 2006 and 2005, respectively, and is included in selling, general, and administrative expenses.

Restructuring and Other Costs (Income), Net

During 2006, we recorded restructuring costs of $0.8 million, which included $0.7 million of severance and associated costs due to a reduction of 15 full-time employees in Canada and France and $0.1 million of equipment relocation costs associated with our 2005 restructuring actions. These costs related to our Papermaking Systems segment.

During 2005, we recorded restructuring income of $0.1 million, which included $0.2 million of restructuring costs and $0.3 million of curtailment gain. The restructuring costs of $0.2 million in 2005 included $0.1 million of income resulting from the reduction in the estimated restructuring costs associated with the Kadant Lamort restructuring initiated in 2004 and $0.3 million in restructuring costs associated with 2005 restructuring actions. The 2005 restructuring costs include $0.2 million of severance and associated costs related to the reduction of 14 full-time positions in the U.S. and $0.1 million for equipment relocation costs, both in our Papermaking Systems segment. The $0.3 million curtailment gain in 2005 resulted from a reduction in the accrued liability for Kadant Lamort s pension plan associated with the Kadant Lamort restructuring initiated in 2004.

Interest Income

Interest income decreased to $1.1 million in 2006 from $1.5 million in 2005 primarily due to lower average cash balances as a result of the acquisitions of Kadant Johnson in May 2005 and Kadant Jining in June 2006.

Interest Expense

Interest expense increased to $3.3 million in 2006 from $2.1 million in 2005 primarily due to the increase in interest expense associated with the $60.0 million in borrowings entered into in May 2005 to fund the Kadant Johnson acquisition, the $10 million in borrowings entered into in May 2006, and the $5.1 million in borrowings entered into in 2006 to fund the Kadant Jining acquisition.

Provision for Income Taxes

Our effective tax rate was 32% and 28% in 2006 and 2005, respectively. The 32% effective tax rate in 2006 consisted of our 33% recurring tax rate, slightly offset by a 1%, or $0.2 million, non-recurring tax benefit related to reductions in tax reserves associated with the favorable resolution of a state tax audit. The 28% effective tax rate in 2005 consisted of our 35% recurring tax rate, offset by a 6% non-recurring tax benefit resulting from a payment of $0.9 million received from our former parent company under a tax agreement and a 1% non-recurring tax benefit related to a reduction of $0.1 million in tax reserves.

Income from Continuing Operations

Income from continuing operations increased to $18.3 million in 2006 from $9.9 million in 2005, an increase of $8.4 million, or 85%. The increase in 2006 was primarily due to a $97.9 million, or 40% increase in revenues which contributed to an increase in operating income of $14.9 million (see *Revenues*, *Gross Profit Margin* and *Operating Expenses* discussed above), offset in part by an increase in interest expense of $1.2 million associated with an increase in borrowings in 2005 and 2006.

Loss from Discontinued Operation

The net loss from our discontinued operation decreased to $1.2 million in 2006 from $3.0 million in 2005. Net losses in 2006 and 2005 were primarily due to $1.2 million and $5.5 million, respectively, of pre-tax warranty provisions.

Liquidity and Capital Resources

Consolidated working capital was $107.5 million at December 29, 2007, compared with $80.5 million at December 30, 2006. Included in working capital are cash and cash equivalents of $61.6 million at December 29, 2007, compared with $39.6 million at December 30, 2006. At December 29, 2007, $45.7 million of cash and cash equivalents was held by our foreign subsidiaries.

2007

Our operating activities provided cash of $31.6 million in 2007, including $33.5 million provided by our continuing operations, offset by $1.9 million used by the discontinued operation. The cash provided by our continuing operations in 2007 was primarily due to income from continuing operations of $25.4 million, a non-cash charge of $7.4 million for depreciation and amortization expense, and a deferred tax provision of $5.9 million. Offsetting these sources of cash in 2007 was an increase in accounts receivable of $5.7 million and an increase in unbilled contract costs and fees of $3.2 million primarily associated with an increase in revenues in our stock-preparation equipment product line. The $1.9 million of cash used by the discontinued operation in 2007 was primarily related to the payment of $2.9 million for warranty claims.

Our investing activities used cash of $7.6 million in 2007, including $8.3 million used by continuing operations and $0.7 million provided by the discontinued operation. The cash used in continuing operations was primarily due to the purchase of $4.9 million of property, plant, and equipment. We also used $2.9 million of cash as consideration in acquisitions, including $2.2 million associated with the Kadant Jining acquisition and $0.9 million associated with the Kadant Johnson acquisition, offset in part by $0.2 million of cash received from the sale of our Casting Products business. The cash provided by the discontinued operation of $0.7 million relates to cash proceeds received in the first quarter of 2007 from the buyer of the assets of Composites LLC for post-closing adjustments.

Our financing activities used cash of $6.7 million in 2007 related entirely to our continuing operations. We used cash of $13.6 million in 2007 for principal payments on our debt obligations, including a $4.3 million prepayment in December 2007, and $5.2 million to repurchase our common stock on the open market. These uses of cash were partially offset by $9.2 million of proceeds from the issuance of common stock in connection with the exercise of employee stock options and $2.9 million of excess tax benefits from share-based payments.

2006

Our operating activities provided cash of $8.2 million in 2006, including $12.3 million provided by continuing operations and $4.1 million used by the discontinued operation. The cash provided by operating activities in 2006 was primarily due to income from continuing operations of $18.3 million, an increase in accounts payable of $11.3 million, and a non-cash charge of $7.8 million for depreciation and amortization expense. Offsetting these sources of cash in 2006 was an increase in unbilled contract costs and fees of $12.1 million and an increase in accounts receivable of $6.9 million. These increases were primarily associated with an increase in revenues in our stock-preparation equipment product line. An additional $8.4 million of cash was used in 2006 due to a reduction of other current liabilities. The reduction of other current liabilities was due primarily to a decrease of $6.7 million in billings in excess of contract costs and fees due to the timing of contracts recognized under the percentage-of-completion method and a decrease of $4.0 million in accrued restructuring costs due to payments made in 2006, offset by an increase in customer deposits of $5.1 million. The $4.1 million of cash used by the discontinued operation in 2006 was primarily related to the payment of $5.8 million for warranty claims.

Our investing activities used cash of $18.1 million in 2006, including $22.4 million used by continuing operations and $4.3 million provided by the discontinued operation. The cash used in continuing operations was primarily due to the use of cash as consideration in acquisitions, including $15.1 million associated with the Kadant Jining acquisition and $2.5 million associated with the Kadant Johnson acquisition. We also purchased $4.1 million of property, plant, and equipment. The cash provided by the discontinued operation of $4.3 million relates to the reduction of restricted cash of $3.5 million held in escrow to satisfy warranty claims and cash proceeds of $0.8 million received in the first quarter of 2006 from the buyer of the assets of Composites LLC for post-closing adjustments.

Our financing activities provided cash of $3.0 million in 2006 related entirely to our continuing operations. We received $10.0 million in proceeds from a commercial real estate loan entered into in May 2006 and $5.1 million in loan proceeds in June 2006 associated with the Kadant Jining acquisition. In addition, we received $9.4 million of proceeds from the issuance of common stock in connection with the exercise of employee stock options and $2.5 million of excess tax benefits from share-based payments. We used cash of $16.6 million in 2006 for principal payments on our debt obligations and $7.2 million to repurchase our common stock on the open market.

Kadant Johnson Acquisition and 2005 Credit Agreement

We completed our acquisition of Kadant Johnson on May 11, 2005 for approximately $114.0 million, of which $101.5 million was paid in cash at closing, $1.6 million was paid in 2006 in settlement of post-closing adjustments, $4.8 million was paid for acquisition-related costs, and $6.1 million of additional consideration is to be paid from 2006 to 2010 related to certain tax assets of Kadant Johnson, the value of which we expect to realize. We paid $0.9 million of this additional consideration in each of 2006 and 2007. The remaining balance, of which $0.9 million is included in other current liabilities and $3.4 million is included in other long-term liabilities in the accompanying consolidated balance sheet, is due over the next three years as follows: $0.9 million in each of 2008 and 2009, and $2.5 million in 2010. To fund $60 million of the purchase price, we entered into a term loan and revolving credit facility (2005 Credit Agreement) effective as of May 9, 2005, as subsequently amended, in the aggregate principal amount of up to $95 million, including a $35 million revolver. The 2005 Credit Agreement included a $60 million term loan (2005 Term Loan), which was repayable in quarterly installments over a five-year period.

In addition, the 2005 Credit Agreement contained negative covenants applicable to us and our subsidiaries, including financial covenants requiring us to comply with a maximum consolidated leverage ratio and a minimum consolidated fixed charge coverage ratio. In addition to the financial covenants, we were also required to comply with covenants related to restrictions on liens, indebtedness, fundamental changes, dispositions of property, making certain restricted payments (including dividends and stock repurchases), investments, transactions with affiliates, sale and leaseback transactions, swap agreements, changing our fiscal year, negative pledges, arrangements affecting subsidiary distributions, and entering into new lines of business. As of December 29, 2007, we were in compliance with these covenants.

On February 13, 2008, in connection with our entering the 2008 Credit Agreement, the 2005 Term Loan of $26 million was repaid and the 2005 Credit Agreement was terminated, including the joinder and guarantee agreements entered into by foreign subsidiary borrowers and certain domestic subsidiaries of Kadant.

2008 Credit Agreement

On February 13, 2008, we entered into a five-year unsecured revolving credit facility (2008 Credit Agreement) in the aggregate principal amount of up to $75 million, which includes an uncommitted unsecured incremental borrowing facility of up to an additional $75 million. We can borrow up to $75 million under the 2008 Credit Agreement with a sublimit of $60 million within the 2008 Credit Agreement available for the issuances of letters of credit and bank guarantees. The principal on any borrowings made under the Credit Agreement is due on February 13, 2013. Interest on any loans outstanding under the 2008 Credit Agreement accrues and is payable quarterly in arrears at one of the following rates selected by us (a) the prime rate plus an applicable margin (up to .20%) or (b) a Eurocurrency rate plus an applicable margin (up to 1.20%). The applicable margin is determined based upon our total debt to earnings before interest, taxes, depreciation and amortization (EBITDA) ratio. On February 13, 2008, we borrowed $20 million under the 2008 Credit Agreement and applied the proceeds to repay a portion of our existing outstanding debt under the 2005 Credit Agreement. We used available cash of $6 million to repay the balance of our outstanding debt under the 2005 Credit Agreement, which was then terminated.

The obligations of Kadant under the 2008 Credit Agreement may be accelerated upon the occurrence of an event of default under the 2008 Credit Agreement, which includes customary events of default including without limitation payment defaults, defaults in the performance of affirmative and negative covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to such matters as Employment Retirement Income Security Act (ERISA), uninsured judgments and the failure to pay certain indebtedness, and a change of control default.

The loans under the 2008 Credit Agreement are guaranteed by certain of our domestic subsidiaries pursuant to the Guarantee Agreement effective as of February 13, 2008. In addition, the 2008 Credit Agreement contains negative covenants applicable to Kadant and its subsidiaries, including financial covenants requiring Kadant to comply with a maximum consolidated leverage ratio of 3.5 and a minimum consolidated fixed charge coverage ratio of 1.2, and restrictions on liens, indebtedness, fundamental changes, dispositions of property, making certain restricted payments (including dividends and stock repurchases), investments, transactions with affiliates, sale and leaseback transactions, swap agreements, changing its fiscal year, arrangements affecting subsidiary distributions, entering into new lines of business, and certain actions related to the discontinued operation.

The amount we are able to borrow under the 2008 Credit Agreement is the total borrowing capacity less any outstanding borrowings, letters of credit and multi-currency borrowings issued under the 2008 Credit Agreement. As of February 13, 2008, we had $50.6 million of borrowing capacity available under the committed portion of the 2008 Credit Agreement.

Commercial Real Estate Loan

On May 4, 2006, we borrowed $10 million under a promissory note (2006 Commercial Real Estate Loan). The 2006 Commercial Real Estate Loan is repayable in quarterly installments of $125 thousand over a ten-year period with the remaining principal balance of $5 million due upon maturity. Interest on the 2006 Commercial Real Estate Loan accrues and is payable quarterly in arrears at one of the following rates selected by us (a) the prime rate or (b) the three-month London Inter-Bank Offered Rate (LIBOR) plus a 1% margin. Effective February 14, 2008, this margin was lowered to .75%. The 2006 Commercial Real Estate Loan is guaranteed and secured by real estate and related personal property of Kadant and certain of its domestic subsidiaries, located in Theodore, Alabama; Auburn, Massachusetts; Three Rivers, Michigan; and Queensbury, New York, pursuant to mortgage and security agreements dated May 4, 2006 (Mortgage and Security Agreements).

Our obligations under the 2006 Commercial Real Estate Loan may be accelerated upon the occurrence of an event of default under the 2006 Commercial Real Estate Loan and the Mortgage and Security Agreements, which includes customary events of default including without limitation payment defaults, defaults in the performance of covenants and obligations, the inaccuracy of representations or warranties, bankruptcy- and insolvency-related defaults, liens on the properties or collateral and uninsured judgments. In addition, the occurrence of an event of default under the 2008 Credit Agreement or any successor credit facility would be an event of default under the 2006 Commercial Real Estate Loan.

Kadant Jining Acquisition, Loans, and Credit Facilities

On June 2, 2006, our Kadant Jining subsidiary assumed responsibility for the operation of Huayi and, by September 30, 2006, acquired the assets of Huayi for approximately $21.2 million, net of assumed liabilities of $2.3 million. Of the total consideration, $17.3 million was paid in cash, including $1.0 million for acquisition-related costs. Of the remaining purchase obligation totaling $3.8 million, $2.4 million was paid as of December 29, 2007, $0.5 million was paid in January 2008 and the remainder will be paid in 2008 if certain indemnification obligations are satisfied.

To finance a portion of the acquisition, on June 6, 2006, Kadant Jining borrowed 40 million Chinese renminbi, or $5.5 million at the December 29, 2007 exchange rate, under a 47-month interest-only loan (2006 Kadant Jining Loan). Interest on the 2006 Kadant Jining Loan accrued and was payable quarterly in arrears based on the interest rate published by The People s Bank of China for a loan of the same term less 10%. The 2006 Kadant Jining Loan was repaid in January 2008.

On July 30, 2007, our Kadant Jining subsidiary and our Kadant Pulp and Paper Equipment Light Machinery Co., Ltd. subsidiary (Kadant Yanzhou) each entered into a short-term credit line facility agreement (Facilities) that would allow Kadant Jining to borrow up to an aggregate principal amount of 45 million Chinese renminbi, or approximately $6.2 million as of December 29, 2007, and Kadant Yanzhou to borrow up to an aggregate principal amount of 15 million Chinese renminbi, or approximately $2.1 million as of December 29, 2007. Both credit facilities have a term of 364 days. Borrowings made under the Facilities will bear interest at 90% of the applicable short-term interest rate for a Chinese renminbi loan of comparable term as published by The People s Bank of China. The Facilities will be used for general working capital purposes. We have provided a guaranty, dated July 30, 2007, securing the payment of all obligations made under the Facilities and providing a cross-default to our other senior indebtedness, including the 2008 Credit Agreement.

On January 28, 2008, our Kadant Jining subsidiary borrowed 40 million Chinese renminbi, or approximately $5.5 million at the December 29, 2007 exchange rate (2008 Kadant Jining Loan). Principal on the 2008 Kadant Jining Loan is due as follows: 24 million Chinese renminbi, or approximately $3.3 million, on January 28, 2010 and 16 million Chinese renminbi, or approximately $2.2 million, on January 28, 2011. Interest on the 2008 Kadant Jining Loan accrues and is payable quarterly in arrears based on the interest rate published by The People s Bank of China for a loan of the same term less 5%. The proceeds from the 2008 Kadant Jining Loan were used to repay the 2006 Kadant Jining Loan totaling $5.5 million at December 29, 2007.

Interest Rate Swap Agreements

To hedge exposure to movements in the variable interest rate on the 2005 Term Loan, we entered into a swap agreement (2005 Swap Agreement), which was effective May 17, 2005, to convert $36 million of the principal balance of the $60 million term loan from a floating rate to a fixed rate of interest. The 2005 Swap Agreement had a five-year term, the same quarterly payment dates as the hedged portion of the term loan, and reduces proportionately in line with the amortization of the 2005 Term Loan. Under the 2005 Swap Agreement, we received a three-month LIBOR rate and paid a fixed rate of interest of 4.125%. On February 13, 2008, we terminated the 2005 Swap Agreement with a resulting loss of $0.4 million, which will be amortized to interest expense through the original maturity date of the 2005 Term Loan.

To hedge the exposure to movements in the variable interest rate on the 2006 Commercial Real Estate Loan, on May 3, 2006, we entered into a swap agreement effective May 5, 2006, which converts the 2006 Commercial Real Estate Loan from a floating rate to a fixed rate of interest (2006 Swap Agreement). The 2006 Swap Agreement has a ten-year term; the same quarterly payment dates as the 2006 Commercial Real Estate Loan, and reduces in line with the amortization of the 2006 Commercial Real Estate Loan. The 2006 Swap Agreement automatically terminates in the event there are no outstanding borrowings under the 2008 Credit Agreement (or successor credit facility), the 2006 Commercial Real Estate Loan, or any other borrowing under which Citizens Bank of Massachusetts is a lender. Under the 2006 Swap Agreement, we will receive a three-month LIBOR rate and pay a fixed rate of interest of 5.63%. The guarantee and default provisions of the 2008 Credit Agreement (and any successor credit facility) and the 2006 Commercial Real Estate Loan, including those contained in the Mortgage and Security Agreements, also apply to the 2006 Swap Agreement.

To hedge the exposure to movements in the 3-month LIBOR rate on outstanding debt, on February 13, 2008, we entered into a swap agreement (2008 Swap Agreement). The 2008 Swap Agreement has a five-year term and a $15 million notional value, which decreases to $10 million on December 31, 2010, and $5 million on December 30, 2011. Under the 2008 Swap Agreement, on a quarterly basis we will receive a 3-month LIBOR rate and pay a fixed rate of interest of 3.265%.

Additional Liquidity and Capital Resources

On May 3, 2006, our board of directors authorized the repurchase of up to $15.0 million of our equity securities during the period from May 18, 2006 through May 18, 2007. We purchased 508,500 shares for $12.4 million under this authorization. On May 2, 2007, our board of directors approved the repurchase by us of up to

$20 million of our equity securities during the period from May 2, 2007 through May 2, 2008. Repurchases under the May 2007 authorization may be made in public or private transactions, including under Securities Exchange Act Rule 10b-5-1 trading plans. As of December 29, 2007, no purchases had been made under the May 2007 authorization.

It is our practice to reinvest indefinitely the earnings of our international subsidiaries, except in instances in which we can remit such earnings without a significant associated tax cost. Through December 29, 2007, we have not provided for U.S. income taxes on approximately $80.9 million of unremitted foreign earnings. The U.S. tax cost has not been determined due to the fact that it is not practicable to estimate at this time. The related foreign tax withholding, which would be required if we remitted the foreign earnings to the U.S., would be approximately $3.1 million.

It is our policy to provide for uncertain tax positions and the related interest and penalties based upon management s assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. At December 29, 2007, we had a liability for unrecognized tax benefits and an accrual for the payment of interest and penalties totaling $5.3 million. To the extent we prevail in matters for which a liability for an unrecognized tax benefit is established or are required to pay amounts in excess of the liability, our effective tax rate in a given financial statement period may be affected.

On October 21, 2005, Composites LLC sold its composites business, presented as a discontinued operation in the accompanying consolidated financial statements. Under the terms of the asset purchase agreement, Composites LLC retained certain liabilities associated with the operation of the business prior to the sale, including warranty obligations related to products manufactured prior to the sale date. Composites LLC retained all of the cash proceeds received from the asset sale and continued to administer and pay warranty claims from the sale proceeds into the third quarter of 2007. On September 30, 2007, Composites LLC announced that it no longer had sufficient funds to honor warranty claims, was unable to pay or process warranty claims, and ceased doing business. At December 29, 2007, the accrued warranty costs for Composites LLC were $2.1 million.

Although we currently have no material commitments for capital expenditures, we plan to make expenditures of approximately $8 to $9 million during 2008 for property, plant, and equipment.

In the future, our liquidity position will be primarily affected by the level of cash flows from operations, cash paid to satisfy debt repayments, capital projects, stock repurchases, or additional acquisitions, if any. We believe that our existing resources, together with the cash available from our credit facilities and the cash we expect to generate from continuing operations, will be sufficient to meet the capital requirements of our current operations for the foreseeable future.

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Contractual Obligations and Other Commercial Commitments

The following table summarizes our known contractual obligations and commercial commitments to make future payments or other consideration pursuant to certain contracts as of December 29, 2007, as well as an estimate of the timing in which these obligations are expected to be satisfied. Detailed information concerning these obligations and commitments can be found in Notes 2, 6 and 7 to our consolidated financial statements.

	Payments Due by Period or Expiration of Commitment				
(In millions)	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Contractual Obligations and Other Commitments: (a)(b)					
Long-term debt obligations (c)	$ 10.2	$ 22.7	$ 1.0	$ 6.8	$ 40.7
Interest (d)	1.9	2.1	1.0	1.3	6.3
Operating lease obligations	2.0	2.3	1.4	0.3	6.0
Kadant Johnson acquisition consideration (e)	0.9	3.4			4.3
Kadant Jining acquisition consideration (f)	1.5				1.5
Letters of credit (g)	14.7	9.2	0.1		24.0
Total (h)(i)	$ 31.2	$ 39.7	$ 3.5	$ 8.4	$ 82.8

(a) We have purchase obligations related to the acquisition of raw material made in the ordinary course of business that may be terminated with minimal notice and are excluded from this analysis.

(b) In the ordinary course of business, we are required to issue limited performance guarantees, which do not require letters of credit, relating to our equipment and systems. We typically limit our liability under these guarantees to amounts that would not exceed the value of the contract. We believe that we have adequate reserves for any potential liability in connection with such guarantees. These guarantees are not included in this table.

(c) As of February 13, 2008, based on the terms of the 2008 Credit Agreement and the termination of the 2005 Credit Agreement, the annual payment requirements for long-term debt obligations are $0.5 million in 2008, $6.5 million in 2009 to 2010, $1.0 million in 2011 to 2012, and $26.7 million in 2013 to 2016.

(d) Amounts assume interest rates on variable rate debt remain unchanged from rates as of December 29, 2007.

(e) In addition to the consideration paid at closing for Kadant Johnson, $4.3 million will be paid through 2010 related to certain tax assets of Kadant Johnson, the value of which we expect to realize.

(f) In addition to the consideration paid at closing for Kadant Jining, $0.5 million was paid in January 2008 and the remaining $1.0 million will be paid in 2008 if certain indemnification obligations are satisfied.

(g) Primarily relates to performance obligations and customer deposit guarantees. This total excludes letters of credit of $11.3 million, which guarantee payment of amounts accrued on the balance sheet and reflected in the table within long-term debt obligations, Kadant Johnson acquisition consideration, and Kadant Jining acquisition consideration. Typically, these performance obligations and customer deposit guarantees have expired without being drawn upon.

(h) This table excludes $0.3 million of accrued restructuring costs and $8.3 million of accrued pension and other post-retirement plans, included in other long-term liabilities in the accompanying consolidated financial statements, as these liabilities are not subject to fixed payment terms. We expect that the accrued restructuring costs will be paid in 2008.

(i) This table excludes a liability for unrecognized tax benefits and an accrual for the payment of interest and penalties totaling $5.3 million. Due to the uncertain nature related to these tax matters, we are unable to make a reasonably reliable estimate if and when cash settlements with the appropriate taxing authorities will occur.

Provisions in financial guarantees or commitments, debt or lease agreements, or other arrangements could trigger a requirement for an early payment, additional collateral support, amended terms, or acceleration of maturity.

We do not have special-purpose entities nor do we use off-balance-sheet financing arrangements.

In the future, our liquidity position will be primarily affected by the level of cash flows from operations and the amount of cash expended on debt repayments, capital projects, stock repurchases, or additional acquisitions, if any. We believe that our existing resources, together with the cash available from our credit facility and the cash we expect to generate from continuing operations, are sufficient to meet the capital requirements of our current operations for the foreseeable future.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in interest rates and foreign currency exchange rates, which could affect our future results of operations and financial condition. We manage our exposure to these risks through our regular operating and financing activities. We entered into receive-variable and pay-fixed swap agreements in 2006 and 2005 to hedge a portion of our variable rate long-term debt. Additionally, we use short-term forward contracts to manage certain exposures to foreign currencies. We enter into forward foreign exchange contracts to hedge firm purchase and sale commitments denominated in currencies other than our subsidiaries local currencies. We do not engage in extensive foreign currency hedging activities; however, the purpose of our foreign currency hedging activities is to protect our local currency cash flows related to these commitments from fluctuations in foreign exchange rates. Our forward foreign exchange contracts principally hedge transactions denominated in U.S. dollars. Gains and losses arising from forward contracts are recognized as offsets to gains and losses resulting from the transactions being hedged. We do not use financial instruments for trading purposes.

Interest Rates

Our cash and cash equivalents are sensitive to changes in interest rates. Interest rate changes would result in a change in interest income due to the difference between the current interest rates on cash and cash equivalents and the variable rates to which these financial instruments may adjust in the future. A 10% decrease in year-end interest rates would have resulted in a negative impact on our net income of $0.1 million in both 2007 and 2006.

A portion of our outstanding debt is sensitive to changes in interest rates. We hedged $30.9 million and $37.9 million of our debt at year-end 2007 and 2006, respectively, with receive-variable pay-fixed swap agreements. The fair values of the swap agreements are sensitive to changes in long-term swap rates. A 10% decrease in the long-term swap rates would have resulted in an increase in unrealized losses of $0.3 million and $0.1 million as of year-end 2007 and 2006, respectively. The remaining unhedged portion of the debt totaling $9.8 million and $16.1 million as of year-end 2007 and 2006, respectively, is sensitive to changes in interest rates. As of year-end 2007 and 2006, the interest rate on the unhedged portion of our U.S. debt was based on LIBOR and for our foreign debt based on rates established by The People s Bank of China. A 10% increase in the year-end rates would have resulted in a negative impact on our net income of $0.1 million in both 2007 and 2006.

Currency Exchange Rates

We generally view our investment in foreign subsidiaries in a functional currency other than our reporting currency as long-term. Our investment in foreign subsidiaries is sensitive to fluctuations in foreign currency exchange rates. The functional currencies of our foreign subsidiaries are principally denominated in euros, British pounds sterling, Mexican pesos, Canadian dollars, Chinese renminbi and Brazilian reals. The effect of changes in foreign exchange rates on our net investment in foreign subsidiaries is reflected in the accumulated other comprehensive items component of shareholders investment. A 10% depreciation in functional currencies at year-end 2007 and 2006, relative to the U.S. dollar, would have resulted in a reduction in shareholders investment of $16.6 million and $13.3 million, respectively.

The fair value of forward foreign exchange contracts is sensitive to fluctuations in foreign currency exchange rates. The fair value of forward foreign exchange contracts is the estimated amount that we would pay or receive upon termination of the contracts, taking into account the change in foreign currency exchange rates. A 10% depreciation in year-end 2007 and 2006 foreign currency exchange rates related to our contracts would have resulted in an increase in unrealized losses on forward foreign exchange contracts of $1.5 million and $0.5 million in 2007 and 2006, respectively. Since we use forward foreign exchange contracts as hedges of firm purchase and sale commitments, the unrealized gain or loss on forward foreign currency exchange contracts resulting from changes in foreign currency exchange rates would be offset by corresponding changes in the fair value of the hedged items.

Item 8. Financial Statements and Supplementary Data

This data is submitted as a separate section to this Report. See Item 15, Exhibits and Financial Statement Schedules.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 29, 2007. The term disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based upon the evaluation of our disclosure controls and procedures as of December 29, 2007, our Chief Executive Officer and Chief Financial Officer concluded that as of December 29, 2007, our disclosure controls and procedures were effective at the reasonable assurance level.

Evaluation of Changes in Internal Controls over Financial Reporting

There have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the fiscal quarter ended December 29, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act Rules 13a-15(f) and 15d-15(f). Our management assessed the effectiveness of our internal control over financial reporting as of December 29, 2007. In making this assessment, our management used the criteria set forth in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management believes that, as of December 29, 2007 our internal control over financial reporting is effective based on the criteria issued by COSO.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our independent registered public accountants, Ernst & Young LLP, have issued an audit report on our internal control over financial reporting, which is included herein on page F-3 and incorporated into this Item 9A by reference.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers, and Corporate Governance

This information will be under the heading Election of Directors in our 2008 proxy statement for our 2008 Annual Meeting of Shareholders and is incorporated in this Report by reference, except as follows. The information concerning executive officers is included under the heading Executive Officers of the Registrant in Item 1 of Part I of this Report.

Section 16(a) Beneficial Ownership Reporting Compliance

The information required under Item 405 of Regulation S-K is included under the heading Stock Ownership Section 16(a) Beneficial Ownership Reporting Compliance in our 2008 proxy statement and is incorporated in this Report by reference.

Corporate Governance

The information required under Item 406 of Regulation S-K will be included under the heading Election of Directors Corporate Governance Code of Business Conduct and Ethics in our 2008 proxy statement and is incorporated in this Report by reference.

Item 11. Executive Compensation

This information will be included under the headings Executive Compensation , Compensation Committee Interlocks and Insider Participation , and Compensation Committee Report in our 2008 proxy statement and is incorporated in this Report by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Except for the information concerning equity compensation plans, this information will be included under the heading Stock Ownership in our 2008 proxy statement and is incorporated in this Report by reference.

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The following table provides information about the securities authorized for issuance under our equity compensation plans as of December 29, 2007:

Equity Compensation Plan Information

Plan Category	(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants, and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants, and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	420,217(1)	$ 26.61(1)	1,186,423(2)
Equity compensation plans not approved by security holders (3)	68,067	$ 13.95	12,002
Total	488,284(1)	$ 24.84(1)	1,198,425(2)

(1) Excludes an aggregate of 263,950 shares of common stock issuable under our employees stock purchase plan in connection with current and future offering periods under the plan. Excludes 2,569 shares reserved for issuance pursuant to our deferred compensation plan for directors.

(2) Includes 263,950 shares of common stock issuable under our employees stock purchase plan in connection with current and future offering periods under the plan. Excludes 2,569 shares reserved for issuance pursuant to our deferred compensation plan for directors.

(3) The material features of our 2001 employee equity incentive plan are described in Part IV, Item 15, Exhibits and Financial Statement Schedules, Note 3 to the audited consolidated financial statements of this Report.

Item 13. Certain Relationships and Related Transactions, and Director Independence

This information will be included under the heading Election of Directors in our 2008 proxy statement and is incorporated in this Report by reference.

Item 14. Principal Accountant Fees and Services

This information will be included under the heading Independent Registered Public Accounting Firm in our 2008 proxy statement and is incorporated in this Report by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this Report:

(1) Consolidated Financial Statements (see Index on Page F-1 of this Report):
Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements and Schedule

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

Consolidated Statement of Income

Consolidated Balance Sheet

Consolidated Statement of Cash Flows

Consolidated Statement of Comprehensive Income and Shareholders Investment

Notes to Consolidated Financial Statements

(2) Consolidated Financial Statement Schedule (see Index on Page F-1 of this Report):
Schedule II: Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or not required, or because the required information is shown either in the consolidated financial statements or in the notes thereto.

(3) Exhibits filed herewith or incorporated in this Report by reference are set forth in the Exhibit Index beginning on page 44. This list of exhibits identifies each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Report.

(b) Exhibits
See the Exhibit Index beginning on page 44.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 11, 2008

KADANT INC.

By: /s/ WILLIAM A. RAINVILLE
William A. Rainville
Chairman of the Board, Chief Executive Officer,

and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated, on March 11, 2008.

Signature	Title
By: /s/ WILLIAM A. RAINVILLE **William A. Rainville**	Chairman of the Board, Chief Executive Officer, and President
By: /s/ THOMAS M. O BRIEN **Thomas M. O Brien**	Executive Vice President, Chief Financial Officer
By: /s/ MICHAEL J. MCKENNEY **Michael J. McKenney**	Vice President, Finance and Chief Accounting Officer
By: /s/ JOHN M. ALBERTINE **John M. Albertine**	Director
By: /s/ JOHN K. ALLEN **John K. Allen**	Director
By: /s/ THOMAS C. LEONARD **Thomas C. Leonard**	Director
By: /s/ FRANCIS L. MCKONE **Francis L. McKone**	Director

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Exhibit Index

Exhibit Number	Description of Exhibit
2.1	Purchase Agreement among the Registrant, Johnson Acquisition Corp., The Johnson Corporation and the principal shareholders of Johnson identified in the Purchase Agreement (filed as Exhibit 99.2 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on April 12, 2005 and incorporated in this document by reference). (1)
2.2	Purchase Agreement dated October 21, 2005, among the Registrant, its Kadant Composites LLC subsidiary, LDI Composites Co., a Minnesota corporation, and Liberty Diversified Industries, Inc., a Minnesota corporation, and parent corporation of the Buyer (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on October 27, 2005 and incorporated in this document by reference). (1)
2.3	First Amendment dated as of October 10, 2006 to the Asset Purchase Agreement dated as of October 21, 2005, among the Registrant, its Kadant Composites LLC subsidiary, LDI Composites Co., a Minnesota corporation, and Liberty Diversified Industries, Inc., a Minnesota corporation, and parent corporation of the Buyer (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 29, 2007 [File No. 1-11406] and incorporated in this document by reference).
3.1	Restated Certificate of Incorporation of the Registrant (filed as Exhibit 3.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 [File No. 1-11406] and incorporated in this document by reference).
3.2	Amended and Restated Bylaws of the Registrant (filed as Exhibit 3.2 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 [File No. 1-11406] and incorporated in this document by reference).
4.1	Rights Agreement, dated as of July 16, 2001, between the Registrant and American Stock Transfer & Trust Company, which includes as Exhibit A the Form of Certificate of Designations, as Exhibit B the Form of Rights Certificate, and as Exhibit C the Summary of Rights to Purchase Preferred Stock (filed as Exhibit 4.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on July 17, 2001, and incorporated in this document by reference).
10.1*	Form of Indemnification Agreement between the Registrant and its directors and officers (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 [File No. 1-11406] and incorporated in this document by reference).
10.2*	Form of Change in Control Agreement between the Company and Mr. William A. Rainville, chairman and chief executive officer of the Company (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on December 8, 2006, and incorporated in this document by reference).
10.3*	Form of Change in Control Agreement between the Company and Other Senior Officers (filed as Exhibit 99.2 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on December 8, 2006, and incorporated in this document by reference).
10.4*	Amended and Restated Nonqualified Stock Option Plan of the Registrant (filed as Exhibit 10.6 to the Registrant s Annual Report on Form 10-K for the year ended December 28, 2002 [File No. 1-11406] and incorporated in this document by reference).
10.5*	Amended and Restated Equity Incentive Plan of the Registrant (filed as Exhibit 10.7 to the Registrant s Annual Report on Form 10-K for the year ended December 28, 2002 [File No. 1-11406] and incorporated in this document by reference).

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Exhibit Index

Exhibit Number	Description of Exhibit
10.6*	2001 Employee Equity Incentive Plan of the Registrant (filed as Exhibit 10.11 to the Registrant s Annual Report on Form 10-K for the year ended December 28, 2002 [File No. 1-11406] and incorporated in this document by reference).
10.7*	Kadant Inc. 2006 Equity Incentive Plan (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 31, 2006, and incorporated in this document by reference).
10.8*	Amended and Restated Deferred Compensation Plan for Directors of the Registrant (filed as Exhibit 10.5 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended July 3, 1999 [File No. 1-11406] and incorporated in this document by reference).
10.9*	Amended and Restated Directors Restricted Stock Plan (filed as Exhibit 10.10 to the Registrant s Annual Report on Form 10-K for the year ended January 3, 2004 [File No. 1-11406] and incorporated in this document by reference).
10.10*	Cash Incentive Plan of the Registrant.
10.11*	Summary of Non-employee Director Compensation of the Registrant.
10.12*	Form of Restricted Stock Agreement for award of restricted shares to non-employee directors used for restricted stock awards prior to February 27, 2007 (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on June 13, 2005 and incorporated in this document by reference).
10.13	Form of Restricted Stock Agreement for award of restricted shares to non-employee directors used for restricted stock awards on and after February 27, 2007 (filed as Exhibit 10.13 to the Registrant s Annual Report on Form 10-K for the year ended December 30, 2006 [File No. 1-11406] and incorporated in this document by reference).
10.14*	Form of Performance-Based Restricted Stock Unit Award Agreement dated May 24, 2007 between the Company and its executive officers (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 [File No. 1-11406] filed with the Commission on August 8, 2007 and incorporated in this document by reference).
10.15*	Form of Performance-Based Restricted Stock Unit Award Agreement between the Company and its executive officers used for restricted stock unit awards on and after March 3, 2008.
10.16*	Form of Restricted Stock Unit Award Agreement between the Company and its non-employee directors used for restricted stock unit awards on and after March 3, 2008.
10.17	Credit Agreement among the Registrant, the Foreign Subsidiary Borrowers from time to time parties thereto, the several banks and other financial institutions or entities from time to time parties thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent, dated May 9, 2005 (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 11, 2005 and incorporated in this document by reference). (1)
10.18	First Amendment to Credit Agreement dated May 9, 2005 among the Registrant, the Foreign Subsidiary Borrowers from time to time parties thereto, the several lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent, dated October 21, 2005 (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended October 1, 2005 [File No. 1-11406] and incorporated in this document by reference).

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Exhibit Index

Exhibit Number	Description of Exhibit
10.19	Second Amendment to Credit Agreement dated May 9, 2005 among the Registrant, the Foreign Subsidiary Borrowers from time to time parties thereto, the several lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent, effective December 28, 2005 (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on January 4, 2006 and incorporated in this document by reference).
10.20	International Swap Dealers Association, Inc. Master Agreement dated May 13, 2005 between the Registrant and Citizens Bank of Massachusetts and Swap Confirmation dated May 18, 2005 (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended July 2, 2005 [File No. 1-11406] and incorporated in this document by reference).
10.21	Third Amendment to the Credit Agreement dated April 3, 2006, among Kadant, the Foreign Subsidiary Borrowers from time to time parties thereto, the several lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent, (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on April 7, 2006 and incorporated in this document by reference).
10.22	Fourth Amendment dated May 9, 2007 to the Credit Agreement dated May 9, 2005 (as amended to date) among the Registrant, the Foreign Subsidiary Borrowers from time to time parties thereto, the several lenders from time to time parties thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent, (filed as Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q [File No. 1-11406] and incorporated in this document by reference).
10.23	Promissory Note in the principal amount of $10,000,000 dated May 4, 2006, between Kadant and Citizens Bank of Massachusetts (filed as Exhibit 99.1 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference).
10.24	Limited Guaranty Agreement dated May 4, 2006 between Kadant Web Systems Inc., a Massachusetts corporation, and Citizens Bank of Massachusetts (filed as Exhibit 99.2 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference).
10.25	Limited Guaranty Agreement dated May 4, 2006 between Kadant Black Clawson Inc., a Delaware corporation, and Citizens Bank of Massachusetts (filed as Exhibit 99.3 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference).
10.26	Limited Guaranty Agreement dated May 4, 2006 between Kadant Johnson Inc., a Michigan corporation, and Citizens Bank of Massachusetts (filed as Exhibit 99.4 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference).
10.27	Mortgage and Security Agreement dated May 4, 2006 between Kadant and Citizens Bank of Massachusetts relating to the real property and related personal property located in Queensbury, New York (filed as Exhibit 99.5 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference). (1)
10.28	Mortgage and Security Agreement dated May 4, 2006 between Kadant Web Systems Inc., a Massachusetts corporation, and Citizens Bank of Massachusetts relating to the real property and related personal property located in Auburn, Massachusetts (filed as Exhibit 99.6 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference). (1)

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Exhibit Index

Exhibit Number	Description of Exhibit
10.29	Mortgage and Security Agreement dated May 4, 2006 between Kadant Black Clawson Inc., a Delaware corporation, and Citizens Bank of Massachusetts relating to the real property and related personal property located in Theodore, Alabama (filed as Exhibit 99.7 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference). (1)
10.30	Mortgage and Security Agreement dated May 9, 2006 between Kadant Johnson Inc., a Michigan corporation, and Citizens Bank of Massachusetts relating to the real property and related personal property located in Three Rivers, Michigan (filed as Exhibit 99.8 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on May 9, 2006 and incorporated in this document by reference). (1)
10.31	Short-term Advised Credit Line Facility Agreement dated as of July 30, 2007 between Kadant Jining Light Machinery Co., Ltd. and JPMorgan Chase Bank, N.A., Shanghai Branch (filed as Exhibit 10.2 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 [File No. 1-11406] and incorporated in this document by reference).
10.32	Short-term Advised Credit Line Facility Agreement dated as of July 30, 2007 between Kadant Pulp and Paper Equipment (Yanzhou) Co., Ltd. and JPMorgan Chase Bank, N.A., Shanghai Branch (filed as Exhibit 10.3 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 [File No. 1-11406] and incorporated in this document by reference).
10.33	Guaranty Agreement dated as of July 30, 2007 between the Registrant and JPMorgan Chase Bank, N.A., Shanghai Branch (filed as Exhibit 10.4 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 [File No. 1-11406] and incorporated in this document by reference).
10.34	Amendment, Acknowledgement and Consent to the Guaranty dated as of January 28, 2008 to the Guaranty Agreement dated as of July 30, 2007 of the Registrant in favor of JPMorgan Chase Bank, N.A., Shanghai Branch.
10.35	Swap Confirmation dated February 13, 2008 between the Registrant and RBS Citizens, N.A.
10.36	RMB 40,000,000 Term Loan Agreement dated as of January 28, 2008 between Kadant Light Machinery (Jining) Co., Ltd. and JPMorgan Chase Bank (China) Company Limited, Shanghai Branch (filed as Exhibit 99 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on February 1, 2008, and incorporated in this document by reference).
10.37	Plan and Agreement of Distribution, dated as of August 3, 2001, between the Registrant and Thermo Electron Corporation (filed as Exhibit 99.3 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on August 6, 2001, and incorporated in this document by reference).
10.38	First Amendment to Plan and Agreement of Distribution, dated as of December 27, 2001, between the Registrant and Thermo Electron Corporation (filed as Exhibit 10.4 to the Registrant s Annual Report on Form 10-K for the year ended December 29, 2001 [File No. 1-11406] and incorporated in this document by reference).
10.39	Tax Matters Agreement, dated as of August 8, 2001, between the Registrant and Thermo Electron Corporation (filed as Exhibit 99.4 to the Registrant s Current Report on Form 8-K [File No. 1-11406] filed with the Commission on August 6, 2001, and incorporated in this document by reference).
18	Letter of Independent Registered Public Accounting Firm regarding change in accounting principle.
21	Subsidiaries of the Registrant.

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Exhibit Index

Exhibit Number	Description of Exhibit
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification of the Principal Executive Officer of the Registrant Pursuant to Rule 13a-15(e) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Principal Financial Officer of the Registrant Pursuant to Rule 13a-15(e) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32	Certification of the Chief Executive Officer and the Chief Financial Officer of the Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Management contract or compensatory plan or arrangement.

(1) The schedules to this document have been omitted from this filing pursuant to Item 601(b)(2) of Regulation S-K. The Company will furnish copies of any of the schedules to the U.S. Securities and Exchange Commission upon request.

Kadant Inc.

Annual Report on Form 10-K

Index to Consolidated Financial Statements and Schedule

The following Consolidated Financial Statements of the Registrant and its subsidiaries are required to be included in Item 8:

The following Consolidated Financial Statement Schedule of the Registrant and its subsidiaries is filed as part of this Report as required to be included in Item 15(a)(2):

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Report of Independent Registered Public Accounting Firm

on Consolidated Financial Statements and Schedule

To the Board of Directors and Shareholders of Kadant Inc.:

We have audited the accompanying consolidated balance sheets of Kadant Inc. as of December 29, 2007 and December 30, 2006, and the related consolidated statements of income, comprehensive income and shareholders investment, and cash flows for each of the three fiscal years in the period ended December 29, 2007. Our audits also included the financial statement schedule listed in the index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kadant Inc. at December 29, 2007 and December 30, 2006, and the consolidated results of their operations and their cash flows for each of the three years in the fiscal period ended December 29, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective December 31, 2006, Kadant Inc. adopted Statement of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* and effective December 30, 2006, Kadant Inc. adopted Statement of Financial Accounting Standards No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132(R)* and effective January 1, 2006, Kadant Inc. adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Kadant Inc. s internal control over financial reporting as of December 29, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts

March 7, 2008

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Report of Independent Registered Public Accounting Firm

on Internal Control over Financial Reporting

To the Board of Directors and Shareholders of Kadant Inc.:

We have audited Kadant Inc. s internal control over financial reporting as of December 29, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Kadant Inc. s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Kadant Inc. maintained, in all material respects, effective internal control over financial reporting as of December 29, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2007 consolidated financial statements of Kadant Inc. and our report dated March 7, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts

March 7, 2008

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Kadant Inc. **2007 Financial Statements**

Consolidated Statement of Income

(In thousands, except per share amounts)	**2007**	**2006**	**2005**
Revenues (Note 11)	$ 366,496	$ 341,613	$ 243,713
Costs and Operating Expenses:			
Cost of revenues	227,716	214,919	149,744
Selling, general, and administrative expenses	95,616	90,236	74,617
Research and development expenses	5,957	6,201	4,887
Loss on sale of subsidiary (Note 2)	388		
Restructuring and other costs (income), net (Note 8)	(219)	815	(118)
	329,458	312,171	229,130
Operating Income	37,038	29,442	14,583
Interest Income	1,570	1,121	1,505
Interest Expense (Note 6)	(3,086)	(3,328)	(2,114)
Income from Continuing Operations Before Provision for Income Taxes and Minority Interest Expense	35,522	27,235	13,974
Provision for Income Taxes (Note 5)	9,784	8,688	3,925
Minority Interest Expense	320	266	184
Income from Continuing Operations	25,418	18,281	9,865
Loss from Discontinued Operation (net of income tax benefit of $1,508, $702 and $1,608 in 2007, 2006, and 2005, respectively; Note 9)	(2,750)	(1,184)	(2,988)
Net Income	$ 22,668	$ 17,097	$ 6,877
Basic Earnings per Share (Note 12)			
Continuing Operations	$ 1.80	$ 1.32	$ .71
Discontinued Operation	(.19)	(.08)	(.21)
Net Income	$ 1.61	$ 1.24	$ .50
Diluted Earnings per Share (Note 12)			
Continuing Operations	$ 1.78	$ 1.30	$ .70
Discontinued Operation	(.19)	(.09)	(.21)
Net Income	$ 1.59	$ 1.21	$ .49
Weighted Average Shares (Note 12)			
Basic	14,116	13,816	13,829
Diluted	14,290	14,097	14,104

The accompanying notes are an integral part of these consolidated financial statements.

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Kadant Inc. **2007 Financial Statements**

Consolidated Balance Sheet

(In thousands, except share amounts)	**2007**	**2006**
Assets		
Current Assets:		
Cash and cash equivalents	$ 61,553	$ 39,634
Accounts receivable, less allowances of $2,639 and $2,623	58,404	49,963
Unbilled contract costs and fees	27,487	24,087
Inventories	47,470	41,679
Other current assets	11,046	8,575
Assets of discontinued operation (Note 9)	1,293	4,461
Total Current Assets	207,253	168,399
Property, Plant, and Equipment, at Cost, Net	41,904	40,939
Other Assets	14,156	11,983
Intangible Assets	32,944	34,686
Goodwill	140,812	137,078
Total Assets	$ 437,069	$ 393,085
Liabilities and Shareholders Investment		
Current Liabilities:		
Current maturities of long-term obligations (Note 6)	$ 10,240	$ 9,330
Accounts payable	37,132	32,934
Accrued payroll and employee benefits	17,510	15,685
Customer deposits	12,956	8,688
Other current liabilities	19,500	19,761
Liabilities of discontinued operation (Note 9)	2,428	1,459
Total Current Liabilities	99,766	87,857
Deferred Income Taxes (Note 5)	8,899	8,761
Other Long-Term Liabilities (Note 3)	17,731	12,833
Long-Term Obligations (Note 6)	30,460	44,652
Minority Interest	1,462	1,017
Commitments and Contingencies (Note 7)		
Shareholders Investment (Notes 3 and 4):		
Preferred stock, $.01 par value, 5,000,000 shares authorized; none issued		
Common stock, $.01 par value, 150,000,000 shares authorized; 14,604,520 shares issued	146	146
Capital in excess of par value	91,753	93,002
Retained earnings	175,106	153,147

Treasury stock at cost, 174,045 and 616,737 shares	(4,152)	(14,401)
Accumulated other comprehensive items (Note 13)	15,898	6,071
Total Shareholders Investment	278,751	237,965
Total Liabilities and Shareholders Investment	$ 437,069	$ 393,085

The accompanying notes are an integral part of these consolidated financial statements.

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Kadant Inc. **2007 Financial Statements**

Consolidated Statement of Cash Flows

(In thousands)	2007	2006	2005
Operating Activities			
Net income	$ 22,668	$ 17,097	$ 6,877
Loss from discontinued operation (Note 9)	2,750	1,184	2,988
Income from continuing operations	25,418	18,281	9,865
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	7,363	7,758	6,931
Stock-based compensation expense	1,796	926	
Loss on sale of subsidiary	388		
Provision for losses on accounts receivable	216	725	185
Minority interest expense	320	266	184
Deferred income tax expense	4,930	5,065	1,511
Other items, net	(2,084)	(1,403)	1,293
Changes in current accounts, net of effects of acquisitions and disposition			
Accounts receivable	(5,657)	(6,941)	(35)
Unbilled contract costs and fees	(3,213)	(12,137)	(493)
Inventories	(3,827)	(3,126)	4,362
Other current assets	(923)	22	542
Accounts payable	2,806	11,280	(4,465)
Other current liabilities	5,976	(8,383)	(817)
Net cash provided by continuing operations	33,509	12,333	19,063
Net cash used by discontinued operation	(1,866)	(4,172)	(1,360)
Net cash provided by operating activities	31,643	8,161	17,703
Investing Activities			
Acquisitions and disposition, net of cash acquired (Note 2)	(2,867)	(17,639)	(103,614)
Acquisition costs capitalized, net			1,563
Acquisition of minority interest in subsidiary		(701)	(1,129)
Purchases of property, plant, and equipment	(4,908)	(4,097)	(3,245)
Proceeds from sale of property, plant, and equipment	157	412	507
Other, net	(633)	(316)	(501)
Net cash used in continuing operations	(8,251)	(22,341)	(106,419)
Net cash provided by discontinued operation	660	4,271	5,548
Net cash used in investing activities	(7,591)	(18,070)	(100,871)
Financing Activities			
Proceeds from issuance of short- and long-term obligations (Note 6)		15,124	60,000
Increase in short- and long-term obligations			4,000
Repayment of long-term obligations (Note 6)	(13,633)	(16,642)	(5,522)
Purchases of Company common stock	(5,185)	(7,181)	(9,116)
Proceeds from issuance of Company common stock (Note 3)	9,225	9,380	1,393
Excess tax benefits from stock option exercises	2,946	2,529	
Payment of debt issuance costs	(25)	(173)	(652)

Net cash (used in) provided by continuing operations	(6,672)	3,037	50,103
Net cash (used in) provided by discontinued operation			
Net cash (used in) provided by financing activities	(6,672)	3,037	50,103
Exchange Rate Effect on Cash from Continuing Operations	1,945	2,538	(2,498)
Change in Cash from Discontinued Operation	2,594	3,146	(5,704)
Increase (Decrease) in Cash and Cash Equivalents from Continuing Operations	21,919	(1,188)	(41,267)
Cash and Cash Equivalents at Beginning of Year	39,634	40,822	82,089
Cash and Cash Equivalents at End of Year	$ 61,553	$ 39,634	$ 40,822

See Note 1 for supplemental cash flow information.

The accompanying notes are an integral part of these consolidated financial statements.

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Kadant Inc. **2007 Financial Statements**

Consolidated Statement of Comprehensive Income and

Shareholders Investment

(In thousands)	2007	2006	2005
Comprehensive Income			
Net Income	$ 22,668	$ 17,097	$ 6,877
Other Comprehensive Items (Note 13):			
Foreign currency translation adjustment	10,859	7,909	(4,564)
Deferred loss on pension and other post-retirement plans (net of reclassification adjustment and net of tax of $211) (Note 3)	(578)		
Unrecognized prior service loss (net of reclassification adjustment and net of tax of $3) (Note 3)	(10)		
Unrecognized transition obligation (net of tax of $2) (Note 3)	(5)		
Deferred (loss) gain on hedging instruments (net of tax of $95, $141 and $133 in 2007, 2006, and 2005, respectively)	(33)	(212)	174
Other Comprehensive Items	10,233	7,697	(4,390)
Comprehensive Income	$ 32,901	$ 24,794	$ 2,487
Shareholders Investment			
Common Stock, $.01 Par Value:			
Balance at beginning and end of year	$ 146	$ 146	$ 146
Capital in Excess of Par Value:			
Balance at beginning of year	93,002	97,297	98,450
Adoption of SFAS 123R		(124)	
Activity under employees and directors stock plans	(4,195)	(6,700)	(1,276)
Tax benefit related to employees and directors stock plans	2,946	2,529	123
Balance at end of year	91,753	93,002	97,297
Retained Earnings:			
Balance at beginning of year	153,147	136,050	129,173
Net income	22,668	17,097	6,877
Adoption of FIN 48	(709)		
Balance at end of year	175,106	153,147	136,050
Treasury Stock, at Cost:			
Balance at beginning of year	(14,401)	(24,254)	(18,158)
Purchases of Company common stock	(5,185)	(7,181)	(9,116)
Activity under employees and directors stock plans	15,434	17,034	3,020
Balance at end of year	(4,152)	(14,401)	(24,254)
Deferred Compensation:			